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## **THE DELAWARE STATUTORY TRUST: An Overview**

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## ***I. BACKGROUND SUMMARY OF THE STATUTORY TRUST***

***A. Introduction.*** A statutory trust (or often times referred to as a “business trust” and will be used interchangeably throughout this summary) is a form of voluntary business association created by a trust instrument pursuant to which property is conveyed to one or more trustees (or the trust itself) to hold and manage the property for the benefit of the beneficial owners. The modern business trust developed in Massachusetts to avoid a statutory provision prohibiting corporations from dealing in real estate. See Minkin v. Commissioner of Revenue, 425 Mass. 174, 680 N.E.2d 27, 30 (1997); Annot., 88 A.L.R.3d 704, 711 (1978). In State Street Trust Co. v. Hall, 31 Mass. 299, 41 N.E. 2d 30, 34 (1942) the Court stated that:

[Business trusts] have been recognized for many years as a common and lawful method of transacting business in this Commonwealth. It has been said that this method of conducting a commercial enterprise originated in this Commonwealth as the result of the inability to secure chargers for acquiring and developing real estate without a special act of the Legislature. Accordingly, the usual purpose of these early organizations was to deal in real estate, but with passing years business trusts have greatly increased in number and have been used extensively in conducting nearly all kinds of industrial and commercial activities.

The statutory trust is structurally analogous to other business entities (corporations, limited partnerships, limited liability companies) where management and control is separated from equitable ownership.

The use of the common law business trust as an alternative business entity has a long history in the United States. See J. Langbein, The Secret Life of the Trust; The Trust as an Instrument of Commerce, 107 Yale L.J. 165 (1997). Its use, however, has (and still does to an extent) present uncertainties and risks that are peculiar to trusts and trust law, including (1) the potential liability of trustees for torts and contracts of the trust; (2) common law trust principles restricting the ability of trustees to delegate powers, act beyond the terms of the trust instrument, or engage in transactions with the trust; (3) possible non-recognition of limited liability of beneficial owners, including imposition of a “control test”; (4) potential non-recognition of the business trust as an entity entitled to transact business; (5) possible restriction on ability to protect trust property from creditors of beneficial owners; and (6) unfavorable tax treatment. However, those risks have been addressed by the statutory recognition of business trusts in a number of states, including Delaware.

***B. Advantage of Business Trusts.*** Business trusts were used to avoid some of the governance and procedural requirements imposed on corporations by the subject State corporation statute. Essentially, the law of the business trust is drafted into the trust instrument. See J. Langbein, The Secret Life of the Trust, 107 Yale L.J. at 184. “The flexibility to eliminate governance procedures that are obligated under the corporate form has been one great attraction of the trust form. For example, the trust instrument can be drafted to dispense with routine shareholder meetings.” (citations omitted). The business trust has also been used to avoid corporate taxation or to otherwise obtain advantageous tax treatment. See e.g., Crocker v.

Malley, 249 U.S. 223 (1919). Finally, the business trust structure could shield its owner/shareholder from personal liability. See Williams v. Inhabitants of Milton, 215 Mass. 1, 8, 102 N.E. 355 (1913). The advantages which led to the proliferation of the business trust as a form of association have been discussed at length by numerous scholarly articles. See J. Langbein, The Secret Life of the Trust, supra; Bogert, Law of Trust and Trustees, §247; Jones, The Massachusetts Business Trust and Registered Investment Companies, 13 Del. J. Corp. L. 421 (1988); C. Magruder, The Position of Shareholders in Business Trusts, 23 Column. L. Rev. 423 (1923); Comment, Massachusetts Trusts, 37 Yale L.J. 1103 (1928); N. Issacs, Trusteeship in Modern Business, 42 Harv. L. Rev. 1048 (1929).

**C. Risks of Using Non-Statutory/Common Law Business Trusts.** Several jurisdictions impose a “control test” to determine shareholder liability – i.e., personal liability is imposed (and the trust is disregarded) when shareholders exercise too much control in the management of the trust. Williams v. Inhabitants of Milton, 215 Mass. 1, 102 N.E. 355 (1913); Frost v. Thompson, 219 Mass. 260, 106 N.E. 1009 (1914). Where shareholders retain control over the trustees, the common law business trust fails and shareholders will not be entitled to limited liability. The First National Bank of New Bedford v. Chartier, 305 Mass. 316, 25 N.E.2d 733 (1940). There was also a risk that other jurisdictions would not recognize a common law business trust as a separate entity or enforce its terms, including the limited liability of shareholders. See Means v. Lumpia Royalties, 115 S.W. 2d 468 (Tex. App. 1938). Common law business trusts were also not always successful at obtaining the desired tax advantages. See Morrissey v. Commissioner, 296 U.S. 344, 80 L.Ed. 263, 56 S. Ct. 289 (1935) (common law business trusts which possessed corporate attributes were held to be taxable associations rather than as property held in trust).

**D. Delaware Statutory Trust Legislation.** Business trust statutes have been enacted by several states, including Delaware, to eliminate many of the uncertainties associated with common law trusts. The Delaware Statutory Trust Act; 12 Del. C. §3801 et seq. (the “Delaware Act”), which was enacted in 1988, provides, among other things, that the business trust is a separate legal entity and that the personal liability of the beneficial owners are limited to the same extent as stockholders in a Delaware corporation. Under the Delaware Act, the rights, obligations and liabilities of the trustees and the beneficial owners of the trust can be varied to suit investors’ needs. The Delaware Act also allows the beneficial owners or even third parties to control the actions of the trustees or other persons authorized to manage the trust. The Delaware Act contains specific provisions that make it attractive for use by registered investment companies, including the authorization of separate series or portfolios. The Delaware Act also contains provisions that enhance the “bankruptcy remote” qualities of a business trust, including limitations on the ability of beneficial owners to trigger dissolution and limitations on the rights of creditors of beneficial owners. In 2002, the legislative amendments to the statute changed the title and all references to “business trusts” within the Delaware Act to “statutory trusts” to avoid any implication that a trust formed under the Delaware Act constitutes a “business trust” under Bankruptcy Code definitions.

## ***II. COMMON CURRENT USES OF BUSINESS TRUSTS.***

- A. Asset-Backed Securities Transactions.***
- B. Collateralized Mortgage Obligations (CMOs and REMICs).***
- C. Real Estate Investment Trusts (REITS).***
- D. Leveraged Leasing Transactions.***
- E. Mutual Funds and Investment Companies.***
- F. Liquidating Trusts.***
- G. Private Investment Funds, Joint Ventures and Strategic Alliances.***
- H. Trust Preferred Securities Transactions.***

## ***III. SUMMARY OF DELAWARE LEGISLATIVE DEVELOPMENTS.***

As mentioned above, the Delaware Act was enacted in 1988 to codify the organizational rules applicable to the “business trust” and to authorize a statutorily recognized flexible alternative business entity. The legislative synopsis to the 1988 statute provides:

This bill statutorily recognized common law trusts created for business purposes as the State of Massachusetts did many years ago. A business trust is the favored form of entity for money market mutual funds, and for real estate investment trusts, and other investment entities involved in the securitization of debt.

Senate Bill No. 355, 66 Del. Laws Ch. 279 (1988); See Nakahara v. The NS 1991 American Trust, Del. Ch., C.A. No. 15905, Chandler, C. (March 20, 1998) slip. op. at 17-18 (“The principal purpose of the [Delaware Act] was to statutorily recognize the existence of the business trust in Delaware, a business form that was implicitly recognized by the statutory laws of the State [of Delaware]”).

The Delaware Act has been and continues to be periodically amended in order to accommodate developments in common business practices. The Delaware Act has been amended in 1990, 1991, 1992, 1996, 1998, 2000, 2002, 2004 and 2006.

Prior to 1998, business trusts were generally recognized under Delaware law although the law applicable to such entities was not entirely clear. Several statutes in the Delaware Code included the term “business trust” in definitions of “person” or “organization.” Two reported Delaware cases discussed, to some degree, the existence and operations of business trusts. In Saminsky v. Abbott, Del. Ch., 185 A.2d 765 (1961) shareholders of an investment company governed by the Investment Company Act and organized as a common law business trust sued

the trustees for excessive recurrent charges and management fees. The court, finding that business trusts are more analogous to corporations than personal trusts, held that the corporate law doctrine prohibiting payment of compensation amounting to waste was applicable to common law business trusts. In Commonwealth Trust Co. v. Capital Retirement Plan, Del. Ch., 54 A.2d 739 (1947), the Court held that a trustee (who, under the trust indenture, had sole authority to manage the trust) was not entitled to receive monthly payments required under the trust indenture where the trustee failed to participate in management of the trust or to provide the required services. The 1988 senate bill expressly provided that the Delaware Act would have no effect on the existence or validity of common law business trusts created before or after the effective date of the statute and that common law business trusts could elect to be governed by the Delaware Act by filing a certificate of trust. 66 Del. Laws Ch. 279, §2 (1988).

For detailed discussion of business trust statutes and various characteristics of business trust, see Bogert, The Law of Trusts & Trustees, §247 (Rev. 2d 3d. 1992); Annotation, Massachusetts or business trusts, 156 A.L.R. 22 (1945); Annotation, Modern Status of the Massachusetts or Business Trust, 88 A.L.R. 3d 704 (1978).

#### ***IV. GENERAL STATUTORY PROVISIONS GOVERNING STATUTORY TRUSTS.***

##### ***A. Definitions.***

**1. Statutory Trust.** The statutory definition of “Statutory Trust” generally incorporates the common law concept and the modern requirements of a written instrument and the filing of a document with the secretary of state. The Delaware Act, for example, provides at §3801(a):

“Statutory trust” means an unincorporated association which:

(1) Is created by a governing instrument under which property is or will be held, managed, administered, controlled, invested, reinvested and/or operated, or business or professional activities for profit are carried on or will be carried on, by a trustee or trustees or as otherwise provided in the governing instrument for the benefit of such person or persons as are or may become beneficial owners or as otherwise provided in the governing instrument, including but not limited to a trust of the type known at common law as a "business trust," or "Massachusetts trust," or a trust qualifying as a real estate investment trust under § 856 et seq. of the United States Internal Revenue Code of 1986 [26 U.S.C. § 856 et seq.], as amended, or under any successor provision, or a trust qualifying as a real estate mortgage investment conduit under § 860D of the United States Internal Revenue Code of 1986 [26 U.S.C. § 860D], as amended, or under any successor provision; and

(2) Files a certificate of trust pursuant to § 3810 of this title.

Any such association heretofore or hereafter organized shall be a statutory trust and a separate legal entity. The term "statutory trust" shall be deemed to include each trust formed under this chapter prior to September 1, 2002, as a "business trust" (as such term was then defined in this subsection). A statutory trust may be organized to carry on any lawful business or activity, whether or not conducted for profit, and/or for any of the purposes referred to in paragraph (a)(1) of this section (including, without limitation, for the purpose of holding or otherwise taking title to property, whether in an active or custodial capacity). Neither use of the designation "business trust" nor a statement in a certificate of trust or governing instrument executed prior to September 1, 2002, to the effect that the trust formed thereby is or will qualify as a Delaware business trust within the meaning of or pursuant to this chapter, shall create a presumption or an inference that the trust so formed is a "business trust" for purposes of Title 11 of the United States Code.

The 2006 legislative amendments to the Delaware Act clarified that a statutory trust "shall be a separate legal entity, the existence of which as a separate legal entity shall continue until cancellation of the statutory trust's certificate of trust." 12 Del. C. § 3810(a).

**2. Governing Instrument.** Under the Delaware Act, a governing instrument is defined as any "any instrument (whether referred to as a trust agreement, declaration of trust or otherwise) which creates a statutory trust or provides for the governance" of its business and affairs. 12 Del. C. §3801(f). The Delaware Act further provides that the governing instrument may consist of one or more documents, including bylaws, and may contain any provision that is not inconsistent with law or the certificate of trust. Id. The 2000 legislative amendments clarified that the governing instrument may consist of separate instruments – one instrument that creates the statutory trust and one or more others that govern its internal affairs. The 2002 legislative amendments clarified that a statutory trust is not required to execute the governing document and is bound by it whether or not the governing document is executed. Id. The 2006 legislative amendments confirm that beneficial owners and trustees are also bound by the governing instrument regardless of whether they sign them. Id.

**3. Beneficial Owner.** The Delaware Act defines a beneficial owner as "any owner of a beneficial interest in a statutory trust, the fact of ownership to be determined and evidenced (whether by means of registration, the issuance of certificates or otherwise) in conformity to the applicable provisions of the governing instrument of the statutory trust." 12 Del. C. §3801(b). Thus, a statutory trust is not required to issue certificates evidencing beneficial interests.

**4. Trustee.** The Delaware Act defines trustee as "the person or persons appointed as a trustee in accordance with the governing instrument of a statutory trust, and may include the beneficial owners or any of them." 12 Del. C. §3801(c). The defined term "person" is broadly defined to include entities as well as natural persons. 12 Del. C. §3801(d).

**B. Formation.** Similar to most limited partnership and limited liability company statutes, the Delaware Act provides that a statutory trust is "formed" at the effective time of the

filing of the initial certificate of trust. 12 Del. C. §3810(a)(2). Section 3810(a)(2) was added to the Delaware Act in the 1996 amendments.

**1. Certificates of Trust.** A Delaware statutory trust must file a certificate of trust with the Delaware Secretary of State, setting forth the following required information: (i) the name of the statutory trust and (ii) the name and address of the Delaware resident trustee (or trustees). 12 Del. C. §3810(a). The certificate of trust may also contain any information that the parties desire including, for example, a future effective date provision, provisions respecting the internal management of the business trust, and provisions, authorized by 12 Del.C. §3804(a), that provide for limitation of liabilities among series or portfolios of the statutory trust. Unless the certificate contains a future effective date provision, it is effective when filed. The certificate of trust must be executed by all of the trustees of the statutory trust. 12 Del.C. §3811(a).

**2. Delaware Resident Trustee.** At least one trustee of a Delaware business trust must be a resident of Delaware, or if a non-natural person, it must have its principal place of business in Delaware. 12 Del. C. §3807. However, if a statutory trust is, becomes or will become a registered investment company under the Investment Company Act of 1940, it is not required to have a resident Delaware trustee so long as such statutory trust has and maintains in Delaware a registered office, which may but need not be its place of business in the state and a registered agent for service of process on the statutory trust. 12 Del. C. §3807(b) and (c).

**3. Certificates of Amendment.** The certificate of trust may be amended at any time by the filing of a certificate of amendment with the Delaware Secretary of State and must be amended if information set forth therein changes rendering the certificate materially false. 12 Del. C. §3810(b). The authority of trustees to amend the certificate may be made subject to requirements set forth in the certificate of trust or the governing instrument, such as a requirement for prior approval by the beneficial owners. A certificate of amendment must be executed by at least one trustee. 12 Del. C. §3811(a)(2).

**4. Restated Certificate of Trust.** The certificate on file with the Secretary of State may be integrated into one restated certificate of trust at any time for any purpose as the trustees may determine. Such certificate must set forth the following: the present name of the statutory trust and the name under which the statutory trust was originally formed if such name has been changed, the date of the filing of the original certificate of trust, and the information required to be included in a certificate of trust. 12 Del. C. §3810(c). A restated certificate must be executed by at least one trustee. 12 Del. C. §3811(a)(2).

**5. Certificates of Correction.** The Delaware Act permits the correction of any certificate filed with the Secretary of State which “is an inaccurate record of the action therein referred to, or was defectively or erroneously executed.” 12 Del. C. §3810(e). A certificate of correction, which must be signed by at least one of the trustees, shall be effective as of the date of filing of the original certificate that is being corrected, except as to those persons who are substantially and adversely affected by the correction. 12 Del. C. §§3810(e) and 3811(a).

**6. Certificate of Cancellation.** The certificate of trust of a statutory trust must be canceled by the filing of a certificate of cancellation upon the completion of winding up of the trust's business. 12 Del. C. §3810(d). The filing of a certificate of cancellation terminates the separate legal existence of the statutory trust. It must be executed by all of the trustees unless otherwise provided in the governing instrument. 12 Del. C. §3811(a)(3).

**7. Execution and Filing of Certificates.** Trustees who execute certificates are deemed to swear or affirm, subject to penalties for perjury, that the facts stated in the certificates are true. 12 Del. C. §3811(c). The Delaware Act also permits any person, including a trustee, to execute any certificate or governing instrument by an agent or attorney-in-fact. 12 Del. C. §3811(b). Signatures on Delaware certificates may be by facsimile and certificates may be filed by electronic transmission. 12 Del. C. §3812(e). Under the Delaware Act, a filing fee of \$200 must be paid at the time of the filing of any certificate and no filing is effective until such fee is paid. 12 Del. C. §§3812(c) and 3813.

**8. Use of Names Regulated.** The name of a statutory trust set forth on the certificate of trust must distinguish the trust from the name of any domestic or foreign corporation, partnership, limited partnership, limited liability company or statutory trust reserved or registered with the Delaware Secretary of State, unless the written consent of the previously registered entity is obtained and filed with the Secretary of State. 12 Del. C. §3814. The name of a statutory trust may contain the name of a beneficial owner or trustee.

### ***C. Contributions by Beneficial Owners.***

**1. Form of Contribution.** Under the Delaware Act, beneficial owners can contribute any form of property to a statutory trust in exchange for its beneficial interest. Moreover, a person may become a beneficial owner or receive a beneficial interest in the statutory trust without making any contribution. 12 Del. C. §3802(a).

**2. Enforcement of Contribution Obligation.** Except as provided in the trust instrument, a beneficial owner is obligated to the statutory trust to perform any promise to contribute to the trust, despite inability to perform because of death, disability or any other reason. If a beneficial owner fails to make a required contribution of property or services, it is obligated at the option of the statutory trust to contribute cash equal to the contribution not made. 12 Del. C. §3802(b). The governing instrument can provide for any type of penalty against the interest of a beneficial owner who fails to make a required contribution. 12 Del. C. §3802(c).

### ***D. Liability of Beneficial Owners and Trustees.***

**1. Beneficiaries.** The modern business trust statutes reject the "control test" that would impose liability on beneficial owners who exert "control" over the trustees or the management of the trust. Under the Delaware Act, for example, except as otherwise provided in the trust's governing instrument, the beneficial owners have the same limitation of personal liability as stockholders of a Delaware corporation. 12 Del. C. §3803(a). Under the Delaware corporate law, shareholder liability for corporate obligations is limited to the shareholder's investment in the corporation. 8 Del. C. §102(b)(6) ("...the stockholders or members of a

corporation shall not be personally liable for the payment of the corporation's debts except as they may be liable by reason of their own conduct or acts.”). Moreover, the Delaware Act expressly permits the beneficial owners to participate in the management of the trust without being deemed trustees or otherwise losing the limited liability that attaches to the status as a beneficial owner. See 12 Del. C. §3801(c) and 3806(a).

**2. Trustees.** Under common law, trustees of business trusts, like trustees of personal trusts, were generally liable for obligations of the trust. Trustee liability was addressed by inserting exculpatory provisions in the governing instrument and, more importantly, in contracts between the trust and third parties. The modern statutes eliminate this concern by providing that trustees are not liable for the statutory trust's obligations. Under the Delaware Act, a trustee is not personally liable to any person, other than to the statutory trust or a beneficial owner, for actions taken while acting in the capacity of trustee. 12 Del. C. §3803(b). With respect to fiduciary duties and liabilities among trustees, the trust and beneficial owners, the statute provides that (1) the trustees will not be liable to the trust or beneficiaries for acts taken in good faith reliance on the provisions of the governing instrument and (2) the fiduciary obligations and liabilities of a trustee may be varied or eliminated by the governing instrument of the trust. 12 Del. C. §3806(c). The implied covenant of good faith and fair dealing in the governing instrument may not be eliminated. Id.

**3. Other Persons.** Since the Delaware Act permits management authority to be vested in or delegated to persons other than trustees, the Delaware Act provides that officers, employees, managers or other persons who may manage the business and affairs of the statutory trust (pursuant to §3806(b)(7) of the Delaware Act) are not personally liable to any person, other than to the statutory trust or a beneficial owner, for actions taken while acting in such capacity. 12 Del. C. §3803(c). Like trustees, manager and officers will have limited liability for good faith actions in reliance on the governing instrument. 12 Del. C. §3806(d).

### ***E. Rights of Beneficial Owners in Trust Property.***

**1. Nature of Beneficial Interest.** Under the Delaware Act, except as provided in the governing instrument, a beneficial owner has an undivided beneficial interest in trust property and “shall share in the profits and losses of the statutory trust in the proportion (expressed as a percentage) of the entire undivided beneficial interest in the statutory trust owned by such beneficial owner.” 12 Del. C. §3805(a). The beneficial interest is personal property and a beneficial owner has no interest in specific trust property. 12 Del. C. §3805(c). The governing instrument of a statutory trust may authorize an unlimited number of shares. See Nakahara v. The NS 1991 American Trust, Del. Ch., C.A. No. 15905, Chandler, C. (March 20, 1998) slip op. at 26 n. 67. Unless otherwise provided in the governing instrument, beneficial interests are freely transferable. 12 Del. C. §3805(d). Once a beneficial owner becomes entitled to a distribution, he or she obtains the status of creditor of the statutory trust with respect to the distribution, except if the governing instrument provides otherwise. 12 Del. C. §3805(e).

**2. Rights of Creditors.** The Delaware Act expressly provides that “[n]o creditor of the beneficial owner shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the statutory trust.” 12 Del.

C. §3805(b). The title to trust property may be vested in one or more trustees, but shall not be subject to claims against the trustee which are unrelated to the statutory trust.

**F. Management of Statutory Trust.** The statutory provisions addressing management of statutory trusts are very flexible and generally defer to the right of the parties to the governing instrument to draft governance provisions appropriate for their needs. This carries on the practice relating to common law business trusts which recognized that the governing instrument essentially established the “law of the entity.” See J. Langbein, The Secret Life of the Trust, supra. The Delaware Act at §3806 provides that, except as otherwise provided in the governing instrument, the business and affairs of a statutory trust shall be managed by or under the direction of its trustee. Moreover, with respect to organizational structure, the Delaware Act permits the governing instrument to create classes or groups of beneficial owners, classes or groups of trustees, separate series or portfolios of the statutory trust, and classes of interests within series. Voting rights and management rights may be granted or denied to any such group or class of beneficial owners or trustees. The 2006 legislative amendments confirm that meetings may be held by telephonic or other communications.

**1. Power to Direct the Trustee.** To the extent provided in the governing instrument, any person (including a beneficial owner) may direct trustees or other persons in the management of the statutory trust. Under §3806(a) neither the power to give direction nor the exercise thereof by any person (including the beneficial owner) shall cause such person to be a trustee. The 1998 amendments to the Delaware Act clarified that there is the contractual power to direct the management of the trust and that such power does not necessarily result in the imposition of fiduciary or other duties on the person exercising such power.

**2. Power to Delegate.** The governing instrument of a Delaware statutory trust may provide for the appointment, election or engagement, either as agents or independent contractors of the statutory trust or as delegates of the trustees, as officers, employees, managers or other persons who may manage the business and affairs of the statutory trust and may have such titles and such relative rights, powers and duties as the governing instrument shall provide. 12 Del. C. §3806(b)(7). Delegating management authority to a person other than the trustee has been recognized for common law business trusts. See Commonwealth Trust Co. v. Capital Retirement Plan, Del. Ch., 54 A.2d 739 (1947) (trustor retained management power over the trust property). The 2004 legislative amendments clarified that the trust agreement “may provide rights to any person, including a person who is not a party to the governing trust, to the extent set forth therein.” §3806(b)(8).

**3. Series or Portfolios.** The Delaware Act permits the governing instrument to establish separate series of the trust which may each have its own investment objective or purpose, beneficial interests, trustees, managers, assets and liabilities. 12 Del. C. §3806(b)(2). The Delaware Act also provides that the debts and liabilities of a series will be enforceable against the assets of that series only and not against the trust’s general assets or the assets of any other series so long as (1) the governing instrument so provides, (2) the certificate of trust sets forth the limitation of interseries liability, and (3) separate and distinct records are maintained for each series and the assets of each series are accounted for separately from the other assets of the trust or any other series thereof. In addition, unless otherwise provided in the governing

instrument, none of the trust's general debts and liabilities or the debts and liabilities of any other series will be enforceable against the assets of such series. 12 Del. C. §3804(a). The 1998 amendments to the Delaware Act further clarified that the dissolution and winding up of a series will not trigger the dissolution of the trust. 12 Del. C. §3808(f).

**4. Treasury Interests.** In 1996, a section was added to the Delaware Act that expressly provided that a statutory trust may redeem or repurchase its beneficial interests and that such repurchased interests will be deemed cancelled, unless otherwise provided in the governing instrument. 12 Del. C. §3818.

**5. Information Rights.** Also in 1996, Section 3819 was added to the Delaware Act to provide for information and inspection rights for beneficial owners similar to the inspection rights of corporate shareholders, limited partners of limited partnerships and members of limited liability companies. See 8 Del. C. §220; 6 Del. C. §§17-305 and 18-305. Unlike the corporate provision, however, the Delaware Act permits the governing instrument to limit or completely restrict the rights of beneficial owners to inspect the books and records of the trust (subject only to public policy and securities laws requirements).

### ***G. Existence and Dissolution of Statutory Trusts.***

**1. Dissolution by Beneficial Owner.** A concern with respect to common law business trusts is the ability of a settlor or a beneficial owner (or a creditor of a beneficial owner) to terminate the trust and gain access to the trust property. Under common law, a beneficial owner does not generally have authority to cause or compel the dissolution of a business trust. State Street Trust Co. v. Hall, 311 Mass. 299, 41 E.E. 2d 30 (1942); But see Papale-Keefe v. Altomare, 38 Mass. App. Ct. 308, 647 N.E.2d 722, 727 (1995) (sole beneficial owner of a Massachusetts business trust was authorized to terminate the trust). The Delaware Act provides that, except as provided for in the governing instrument, the statutory trust shall have perpetual existence, and a statutory trust may not be terminated or revoked by a beneficial owner or other person except in accordance with the terms of its governing instrument. 12 Del. C. §3808(a). Moreover, the death, incapacity, dissolution, termination or bankruptcy of a beneficial owner will not cause termination of a Delaware statutory trust. 12 Del. C. §3808(b). The 2006 legislative amendments set forth that the existence of a statutory trust that has encountered an event of dissolution under its governing instrument may be continued by the unanimous vote of beneficial interest holders.

**2. Dissolution and Winding Up of a Statutory Trust.** The Delaware Act, as amended in 1996, provides for dissolution procedures analogous to dissolution procedures for limited partnerships and limited liability companies. The Delaware Act does not provide any specific events of dissolution but instead leaves it entirely up to the governing instrument to provide dissolution events. 12 Del. C. §3808(a), (b) and (c). The Delaware Act does require that a person designated in the governing instrument wind up the affairs of the trust. 12 Del. C. §3808(d). The Delaware Act also requires that all current, contingent and unmatured claims and liabilities be paid in full or provided for prior to any distribution to beneficial owners. 12 Del. C. §3808(e). A trustee who complies with Section 3808(e) will not be liable to claimants of the dissolved statutory trust by reason of the trustee's actions in winding up the trust. Id. The 1998

Amendments to the Delaware Act require that the winding up of dissolved series must follow the same requirements to satisfy claims prior to distributing assets to beneficial owners of such series. 12 Del. C. §3808(g).

**H. Applicability of Trust Law.** Traditional trust principles are generally applicable to common law business trusts. See Papale-Keefe v. Altomare, 38 Mass. App. Ct. 308, 647 N.E.2d 722, 726 (1995). Under the Delaware Act, Delaware common law trust principles will apply to Delaware statutory trusts to the extent not otherwise provided in the governing instrument or the Act. 12 Del. C. §3809. However, notwithstanding this provision, it is likely that corporation law fiduciary concepts (as opposed to potentially more stringent trust law) will apply, at least by analogy, to trustees of statutory trusts that are structured similarly to corporations. See Richardson v. Clark, 372 Mass. 859, 861-862, 364 N.E.2d 804 (1977) (“Business trusts possess many of the attributes of corporations and for that reason cannot be governed solely by the rules which have evolved for traditional trusts.”); Saminsky v. Abbott, Del. Ch., 185 A2d 765 (1961). Also, several other business trust statutes provide that corporate law will govern the affairs of the business trust. See Indiana Code Ann. §23-5-1-9 (1998); Kansas Stat. Ann. §17-2035 (1997). The 2006 legislative amendments set forth that a governing instrument may not eliminate the implied contractual covenant of good faith and fair dealing.

### **I. Merger and Consolidation; Conversions.**

**1. Merger.** The Delaware Act provides that a statutory trust may merge or consolidate with another business entity under the laws of Delaware or any other jurisdiction. 12 Del. C. §3815. Unless otherwise provided in the governing instrument, all trustees and all beneficial owners must approve a merger. In order to effect a merger, the statutory trust must enter into a merger agreement with the constituent entities to the merger and file a certificate of merger or consolidation with the Secretary of State. The Certificate of Merger must set forth the name and jurisdiction of the merging entities and the name of the surviving entity, that an agreement of merger or consolidation has been executed, that it is on file at the place of business of the surviving entity and that it will be furnished to any interested person. If no Delaware entity survives, the Certificate of Merger must also include the surviving entity’s consent to process, an appointment of the Secretary of State as agent and an address to which the Secretary may mail a copy of such process. The agreement of merger or consolidation may effect any amendment to the governing instrument or adoption of a new governing instrument if a statutory trust is the surviving entity. The 2004 Amendments added a new paragraph (4) clarifying that a name change to the surviving trust due to a merger is effected by the merger. §3815(b)(4). In addition, the 2004 Amendments provide that no further action is needed to amend a certificate of trust when a certificate of merger sets forth any amendment in accordance with the new §3815(b)(4). 12 Del. C. §3815(e).

**2. Conversions.** The 2004 legislative amendments provided for a new §3821 that sets forth the conversion process of a statutory trust to another business entity, Delaware or non-Delaware. The legislation sets forth the filing process, and the rights, obligations and liabilities associated with the conversion of the existing statutory trust.

## ***J. Legal Proceedings.***

**1. Process and Jurisdiction.** Common law business trusts are generally treated as distinct legal entities for purposes of suit. See Great Bay Hotel & Casino, Inc. v. The City of Atlantic City, 624 A.2d 102, 105 (N.J. Super. 1993). Under the Delaware Act, a statutory trust may sue and be sued for debts, obligations or liabilities incurred by trustees or their agents. 12 Del. C. §3804(a). Service of process in Delaware on the trust can be effected by serving the Delaware resident trustee or, if the trust is a registered investment company under the Investment Company Act of 1940 (the “1940 Act”), by serving the trust’s registered agent in Delaware. 12 Del. C. §3804(b). A person shall not be deemed to be doing business in Delaware solely by reason of being a beneficial owner or trustee of a domestic statutory trust or a foreign statutory trust. 12 Del. C. § 3863(b). However, Section 3863, which also identifies activities not constituting doing business in Delaware, does not apply to determining whether a foreign statutory trust is subject to service of process. 12 Del. C. § 3683(c). Finally, a governing instrument may subject a trustee to the non-exclusive jurisdiction of any state or the exclusive jurisdiction of the courts of the State of Delaware.

**2. Derivative Actions.** The beneficial owners have a right to bring an action in the right of the statutory trust if trustees with authority to do so, refuse to bring the action or efforts to cause the trustees to bring the action are unlikely to succeed. The Delaware Act imposes the requirement that the plaintiff must be a beneficial owner at the time of bringing the action and the time of the transaction of which he or she complains. 12 Del. C. §3816. The complaint must set forth the efforts taken to compel the trustees to bring the action or the reason for not taking such efforts. The requirements are derived from Delaware statutory and case law respecting corporate shareholder derivative actions. See 8 Del. C. §327. Unlike Delaware corporate law, however, the Delaware Act authorizes the governing instrument to impose standards or restrictions on the bringing of a derivative action, such as requiring that a minimum percentage of beneficial owners must join in bringing a derivative action. 12 Del. C. §3816(e).

The 2000 legislative amendments clarified that with respect to a statutory trust that is an investment company under the 1940 Act, the determination of whether a trustee is independent and disinterested will be made in accordance with the 1940 Act.

**K. Indemnification.** The Delaware Act provides that, subject to any restrictions in the governing instrument, the statutory trust may indemnify any trustee, beneficial owner or other person from and against any and all claims and that the absence of an indemnity provision in the governing instrument will not deprive any person of the right to indemnity otherwise available under Delaware law. 12 Del. C. §3817. The Delaware Court of Chancery has similarly held that the governing instrument will not deprive any person of the right to indemnity otherwise available under Delaware law. The Delaware Court of Chancery has also held that the governing instrument of a Delaware statutory trust may contain a mandatory or permissive advancement of expenses provision notwithstanding the fact that Section 3817 refers only to indemnification and not advancement. Nakahara v. The NS 1991 American Trust, Del. Ch., C.A. No. 15905, Chandler, C. (March 20, 1998) slip op. at 26-27 (“[T]he language of the [Delaware Act’s] indemnification provision is broad and flexible. Such a general authorization

of indemnification compels a permissive interpretation with the language intended to authorize as much as possible and exclude only that which is expressly prohibited.”).

**L. Construction of Statutes.** The Delaware Act provides that the rule that statutes in derogation of the common law will be strictly construed does not apply to the Delaware Act. 12 Del. C. §3825(a). The Delaware Act states also that it “is the policy of this chapter to give maximum effect to the principles of freedom of contract and to the enforceability of governing instruments.” 12 Del. C. §3825(b). These are the same provisions that are included in the Delaware Revised Uniform Limited Partnership Act, 6 Del. C. §17-101, et seq., and the Delaware Limited Liability Company Act, 6 Del. C. §18-101, et seq., and have been given effect by the Delaware courts. Nakahara, slip op. at 29 (“Clearly the Legislature intended to provide Delaware business trusts and limited partnerships wide latitude in the drafting of their governing instruments.”).

## **V. FOREIGN BUSINESS TRUSTS; DOING BUSINESS IN OTHER STATES**

**A. Common Law Concerns.** There is a risk that a common law business trust may not be recognized outside the state of its formation. There are several cases in which courts have treated business trusts as general partnerships or have otherwise denied the business trust the benefits of the terms of the trust documents. In Means v. Lympia Royalties, 88 S.W. 2d 1080 (Tex. App. 1935), a Texas court held that Texas beneficiaries of a business trust are treated as partners and are liable for the debts of the trust even though in Oklahoma they are not liable. J. Shafran, Investment Trusts and the Conflict of Laws, 50 Cal. L. Rev. 696 (1962). The public policy of the forum state may also have an impact on whether a court will enforce the terms of a trust document and apply the law of the state of formation of a business trust. See C. Cole, Jr., Conflict of Laws; Choice of Law and the Foreign Real Estate Investment Trust, 26 Okla. L. Rev. 295, 399 (1973).

**B. Statutory Treatment of Foreign Business Trusts.** The 1998 amendments to the Delaware Act added a series of provisions which require foreign business trusts to register with the Secretary of State before doing business in Delaware (12 Del. C. §3851 et seq.).

*This document is prepared for information purposes only. Please contact Ellisa Opstbaum Habbart at The Delaware Counsel Group LLP if you have specific questions regarding this information.*

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