

## **DELAWARE STATUTORY TRUSTS**

### **INTRODUCTION**

Trust relationships have existed under the common law for centuries. Courts allowed property ownership to be divided such that a fiduciary would hold legal title to property on behalf of another who was said to hold equitable title. However, such trusts were not legal entities; rather, they were simply fiduciary relationships between a trustee and a beneficiary. The desire to have an entity that would be created pursuant to and governed by a statutory framework that would provide legal certainty fueled the enactment of the Delaware Statutory Trust Act<sup>1</sup> (the “Act”) in 1988. The Act expressly designates trusts formed thereunder (“Delaware Statutory Trusts”) as legal entities and provides a statutory regime to govern their existence. Although other jurisdictions have similar statutes, Delaware is the undisputed forum of choice for the creation of a statutory trust.

### **PURPOSES**

The Delaware Statutory Trust is used in a variety of transactions and structures. Delaware Statutory Trusts are used as vehicles for investment, as legal entities for the conduct of business, and as special purpose entities for the holding of title to assets. The flexibility of the Act as to the operation, management and activities of the trust and the limited liability granted to beneficial owners have made Delaware Statutory Trusts the perfect vehicle for a diverse range of business transactions.

In the real estate context, Delaware Statutory Trusts serve in a number of different types of transaction structures. In connection with liability concerns, Delaware Statutory Trusts are used to hold title to real estate. Title to the property is held by the trust as a legal entity, and the beneficial owners enjoy the protections of limited liability afforded by the Act.

Delaware Statutory Trusts also are used in connection with tax matters. Delaware Statutory Trusts are used to serve as the entity to hold title to real estate and to qualify as a “real

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<sup>1</sup> 12 *Del.C.* § 3801 *et seq.*



estate investment trust” for tax purposes. Additionally, Delaware Statutory Trusts are utilized as entities to hold title to real estate for purposes of investment and the tax advantages afforded in 1031 exchanges. With respect to transfer taxes, Delaware Statutory Trusts are employed in some jurisdictions to reduce transfer taxes associated with transfers of title.

Insolvency matters are the reason Delaware Statutory Trusts are used in many types of real estate related structured financing transactions. Title to property is held by the trust for the benefit of a beneficial owner rather than directly by such party, and it is the trust that serves as the borrower under a loan. An objective in such structured financing transactions is to insulate the property from the insolvency of the underlying beneficial owner.

In addition to the foregoing uses, Delaware Statutory Trusts frequently are chosen to hold title to property in order to take advantage of the provisions of the Act that allow for series within the Delaware Statutory Trust. The series provisions of the Act are an advantage in finance transactions that wish to avoid the hassles associated with the mechanics of multiple and/or frequent transfers of title. In such transactions, the Delaware Statutory Trust maintains legal title while equitable title is transferred among beneficiaries of the trust.

## **FORMATION**

Formation of a Delaware Statutory Trust is fairly easy. Under the Act, the following is required for a Delaware Statutory Trust to exist: (i) a governing instrument (typically a trust agreement), (ii) a certificate of trust filed with the Office of the Secretary of State of the State of Delaware (the “Delaware Secretary of State”), (iii) one or more trustees, and (iv) one or more beneficial owners.

### ***A. The Governing Instrument***

A governing instrument is the document or documents governing the creation and internal affairs of the trust and the conduct of its activities.<sup>2</sup> The governing instrument must be in writing and executed on or prior to the filing of the certificate of trust. There is no requirement as to the length of the governing instrument, and with proper drafting the agreement can be straightforward and uncomplicated. With respect to the substance of the governing instrument, the Act sets forth a broad framework for the creation and operation of Delaware Statutory Trusts. This broad framework allows great flexibility within a governing instrument,

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<sup>2</sup> 12 *Del.C.* § 3801(c).

giving parties wide contractual freedom as to the terms of the governing instrument and the resulting operation of the trust.

***B. The Certificate of Trust***

The Act requires the filing of a certificate of trust for each Delaware Statutory Trust.<sup>3</sup> The certificate of trust is filed with the Delaware Secretary of State and is the only document that needs to be filed with the Delaware Secretary of State in connection with the creation of the Delaware Statutory Trust. The certificate of trust is required to contain the name of the trust and the name and address of one trustee in the State of Delaware. Additional matters may be included in the certificate of trust, though most parties choose to include such matters in the governing instrument instead. Particularly attractive to transaction parties is the responsiveness and accessibility of the Delaware Secretary of State. Facsimile copies, as well as conformed and counterpart signature pages, are accepted, and certified copies of certificates of trust and good standing certificates can be obtained on an expedited basis - in as quickly as an hour.

***C. Trustees***

Every Delaware Statutory Trust must have at least one trustee and may have more than one trustee. A trustee may be a beneficial owner and may be a natural person or a business entity. A Delaware Statutory Trust must have at least one trustee in the State of Delaware.<sup>4</sup>

***D. Beneficial Owners***

Under the Act, a beneficial owner is defined as one who is the owner of a beneficial interest in a Delaware Statutory Trust.<sup>5</sup> The Act leaves it to the governing instrument to set out the details of the rights, obligations and activities associated with beneficial ownership. A beneficial owner may acquire its interest through the contribution of cash, property or services rendered or the promise to make such a contribution. However, the Act also allows a person to become a beneficial owner of a Delaware Statutory Trust without making or promising to make a contribution. Under the Act, unless the governing instrument provides otherwise, a beneficial owner is entitled to the same limitation of personal liability extended to stockholders of private,

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<sup>3</sup> 12 *Del.C.* § 3810.

<sup>4</sup> If a natural person, the trustee must be a resident of Delaware. If the trustee is a legal entity, it must have a principal place of business in Delaware. An exception exists for trusts that are or that will become a registered investment company under the Investment Company Act of 1940. *See* Section 3807(b) of the Act.

<sup>5</sup> 12 *Del.C.* § 3801(a).

for profit corporations for profit organized under the General Corporation Law of the State of Delaware.<sup>6</sup>

### **RIGHTS IN TRUST PROPERTY**

Unless the governing instrument provides otherwise, a beneficial owner of a Delaware Statutory Trust has an undivided beneficial interest in the property of the Delaware Statutory Trust. In addition, except to the extent provided otherwise in the governing instrument, a beneficial owner of a Delaware Statutory Trust has no interest in specific property of the Delaware Statutory Trust. Unless provided otherwise in the governing instrument, a beneficial interest is freely transferable.

Under the Act, no creditor of a beneficial owner or of a trustee in its individual capacity has the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the Delaware Statutory Trust.

### **MANAGEMENT OF A STATUTORY TRUST**

The Act is intended to give great flexibility to parties in structuring their trust and maximum effect to the principle of freedom of contract. Section 3806(b) of the Act provides that “a governing instrument may contain any provision relating to the management of the business and affairs of the statutory trust...which is not contrary to any provision or requirement of [the Act].”

As a default rule, the trustees of a Delaware Statutory Trust manage the business and affairs of the trust. However, management of a Delaware Statutory Trust can be completely or partially divested from the trustees and placed with other persons. Management can be vested in officers, employees, managers or other persons, either as agents or independent contractors of the Delaware Statutory Trust. Such parties may have the relative rights, powers and duties as the governing instrument provides. In addition, the governing instrument may provide specific direction with respect to virtually all aspects of the operation of the Delaware Statutory Trust such that there is little or nothing left to actually manage.

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<sup>6</sup> 12 *Del.C.* § 3803(a).

## **MERGER, CONSOLIDATION AND CONVERSION**

The Act permits a Delaware Statutory Trust to merge or consolidate with one or more Delaware Statutory Trusts or other business entities. In addition, the Act permits any other business entity to convert into a Delaware Statutory Trust and permits a Delaware Statutory Trust to convert into another business entity. The conversion of a Delaware Statutory Trust does not require that the trust wind up its affairs. In addition, for purposes of Delaware law, the conversion vests in the other business entity all of the rights, privileges, powers, property and debts of the Delaware Statutory Trust, and upon effectiveness of the conversion, the other business entity is deemed to be the same entity as the Delaware Statutory Trust.

## **DISSOLUTION AND WINDING UP**

Under the Act, unless provided otherwise in the governing instrument, a Delaware Statutory Trust has perpetual existence. The trust may not be terminated or revoked by a beneficial owner or other person except in accordance with the terms of the governing instrument. Further, the Act provides that, except to the extent otherwise provided in the governing instrument, the death, incapacity, dissolution, termination or bankruptcy of a beneficial owner does not result in the termination or dissolution of a Delaware Statutory Trust. Upon dissolution and wind-up of a Delaware Statutory Trust, a certificate of cancellation is filed with the Delaware Secretary of State, which has the effect of terminating the Delaware Statutory Trust's legal existence.

## **CONCLUSION**

Delaware Statutory Trusts and the Act are intended to provide maximum flexibility and legal certainty to meet the business and financial needs of the business community. In addition to these advantages, parties using Delaware Statutory Trusts enjoy the benefits of Delaware's courts, which are experienced in resolving business disputes, and the benefits of Delaware's legislature and administration, which are renowned for their positive attitude toward business and innovation, thus making the Delaware Statutory Trust a preferred choice of the business community.