

**A BUSINESS REVIEW OF THE DELAWARE SERIES: GOOD BUSINESS FOR  
THE INFORMED**

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“Co-operation, not competition, will prove most rational in the months to  
come....” Anonymous, 2006

**THESIS**

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Delaware has long attempted to provide business structures that reflect the demands of the business community in an efficient and productive manner. One prime example of this demand/response is the “series” interest available in Delaware limited partnerships, LLCs, and statutory trusts. The series structure combines the flexibility that different types of businesses desire along with the statutory and contractual support that Delaware provides to all of its unincorporated business organizations. Other states have now emulated the Delaware series concept, although there is still considerable confusion as to how a series works. This piece provides an overview of some of the more significant provisions of the Delaware series law. The author concludes that the Delaware series provides a beneficial, efficient use of a combined contractual Delaware entity form with sensible, informed planning.

## ABSTRACT - OPENING CONSIDERATION

The concept of the Delaware “series”<sup>2</sup> first arose in the context of the

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<sup>2</sup> This article focuses solely upon the Delaware series due to its originality and national popularity. Six other jurisdictions have followed Delaware and adopted “series” legislation: (1) **Iowa**, Iowa Code § 490A. 305 (adopted 1997); compare 6 Del.C. § 18-215 (basically follows Delaware series except that termination requires consent of all members rather than 2/3 percentage in interest); (2) **Illinois**, 805 ILCS § 190/37-40(b)(Effective 8/6/2005);(similar to Delaware series under the 2007 amendments except series itself files to create separate existence and is deemed a separate “entity; Illinois series addresses tax status by providing that an LLC and any series may elect to consolidate their business as a single taxpayer “to the extent permitted under applicable law.”); (3) **Nevada**, Nev. Rev. Stat., § 86.011 et seq. (adopted 2005)(similar to Delaware series except that series provisions found throughout statute instead of in one central location - making it more difficult for practitioner use; Nevada imposes an initial filing fee of \$75.00 for an LLC and separate filing fees for each series; an annual filing fee of \$125.00 is required for each series - a money-enhancer for Nevada.); (4) **Oklahoma**, 18 Okla. St. Ann. § 2054.4, (follows Delaware approach); (5) **Utah**, Utah Code Ann. § 48-21-606 et seq., (enacted in 2006)(follows Delaware separateness test but, like Illinois and Delaware 2007 amendments, allows series to contract but does not consider the series to be an entity; a foreign application requires identification of protections available in the Utah act as well as any different protections not found in the Utah act); (6) **Tennessee**, Tenn. Code Ann. § 48-249-309 et seq. (adopted 2006)(Similar to Delaware, follows separateness test; allows for registration of foreign series LLCs with consequence of failing to file being loss of statutory liability protection for one series against the liabilities of another series).

For an offshore series LLC, the Republic of the Marshall Island permits the creation of series LLCs. RMI, PL 2000-14, § 79. The RMI series is modeled after Delaware.

Delaware Business<sup>3</sup>, now Statutory, Trust Act (DSTA).<sup>4</sup> The purpose of the series was to allow persons managing, controlling or operating certain business activities in a manner known at the common law as a “business trust” or “Massachusetts trust” to segregate similar assets. In the mutual fund context, one trust could be created and a distinct series of the trust could be formed for each asset class within the trust. The reason for the series mutual fund was that a single legal entity could be formed - typically a corporation for liability purposes - and that entity could achieve centralized management (a board of directors) and could operate under a single registration under the Investment Company Act of 1940.<sup>5</sup> The original investment purpose of the series was expanded in the DSTA to include any business purpose. The series was thereafter adopted in Delaware’s LLC Act. The series concept that has now taken a center stage is found in Delaware’s immensely popular Limited Liability Company Act (“DLLCA”).<sup>6</sup>

## I. INTRODUCTION

The Delaware “series” began its life as a signature feature in the former Delaware Business Trust Act<sup>7</sup> where transactions generally involved mutual funds or highly financed asset securitizations. In this industry, investors found it highly desirable to be able to “group,” “class” or place into “series” similar real estate investment mortgages, real estate mortgage income investments or like assets that were to be used as securitization devices. For example, if a manager were controlling a fund of 15-year real estate mortgage income investment devices, 30-year real estate mortgage income investment devices, and 5-year real estate

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<sup>3</sup> The original Delaware Business Trust Act was adopted in 1988.

<sup>4</sup> 12 Del.C. §§ 3801 et seq.

<sup>5</sup> In *National Securities Series-Industrial Stock Series*, 13 TC 884, Dec. 17, 299 (1949), the Tax Court decided that several series within a single investment trust could be treated as separate taxable entities.

<sup>6</sup> In 2006, 96,831 new LLCs were formed in Delaware compared with 34, 733 new corporations. Limited partnerships came in third place with 9,948 new formations and statutory trusts followed with 3,868 new entities. [Http://www.corp.delaware.gov.2006%20Annual%06](http://www.corp.delaware.gov.2006%20Annual%06)

<sup>7</sup> The Delaware Business Trust Act was originally enacted in 1988, however the series language was not brought into the Act until July 5, 1990. See Senate Bill No. 452, Volume 67, Chapter 296 of the Laws of Delaware.

mortgage income investment devices, a series allows the segregation of the *types* of income investment devices into separate series and the subsequent allocation of income from the identified investments to express beneficiaries, or trustees. The series anticipates separate record-keeping for these 15-year, 30-year, and 5-year income investments with notice of the three series being set forth in the certificate of trust. If appropriate “records and notices” are maintained concerning these series of assets, then the debts, obligations, liabilities and expenses contracted for or otherwise associated with these particular series are enforceable only against the series and not against the trust generally or other series of the trust.

Because sophisticated, highly-funded deals were commonplace for use by Delaware limited partnerships, the Delaware Revised Uniform Limited Partnership Act (“DRULPA”) was amended in 1996, effective 1997, to add a concept of “series” to its arsenal of contractual features.<sup>8</sup> The term “series,” however, was not added to the Delaware Revised Uniform Partnership Act (“DRUPA”). The DRUPA does permit “classes and groups” of partners with such “rights, powers, and duties” as the partnership agreement provides.<sup>9</sup> Whether an LLP could form “classes” of partners, allocate assets to particular classes, structure a “records and notice” series procedure through the partnership agreement, file a statement of partnership existence, and file for LLP status<sup>10</sup> that would be enforceable as a “series” is unlikely since the *statutory power* to create a *limitation on liabilities* for a true statutory “series” is absent.<sup>11</sup> Of course, the DRUPA does clearly state that the policy of the Act is to “give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.”<sup>12</sup> DRUPA does not, however, create a statutory *series limitation on liability*.

The Delaware Limited Liability Company Act, enacted in 1992, adopted

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<sup>8</sup> 6 Del.C. § 17-218. The Delaware Revised Uniform Limited Liability Partnership Act was revised in 1996 to include a “series” of “limited partners, general partners or partnership interests” provision. The revisions became effective August 1, 1997. The Delaware Revised Uniform Partnership Act (DRUPA) adopts a “classes and groups” formulation for voting purposes. 6 Del.C. § 15-407. The DRUPA does not have a “series” limitation on liabilities provision.

<sup>9</sup> 6 Del.C. § 15-406.

<sup>10</sup> 6 Del.C. § 15-1001.

<sup>11</sup> See Ann E. Conaway, *The Contractual Duty of Good Faith and Fair Dealing: Why No Respect?* <http://ssrn.com/abstract=994624>.

<sup>12</sup> 6 Del.C. § 15-103(d).

series language in 1996 as well as the “class or group” formulation as set forth in the DRUPA.<sup>13</sup> The DLLCA series provision is significantly more detailed in its description of the series than is in the original Delaware Business Trust Act. The descriptive language of the DLLCA series serves to provide notice as to how to safeguard the separate features of each series for the purpose of limiting the liability of a series obligation to that series’ assets. There is no legislative record indicating that either the “series” language set forth in the present Delaware Statutory Trust Act, the DLLCA, or the DRULPA was intended to serve as a mini “*entity*” within an “entity” - a current “hot topic” within the unincorporated entity marketplace.

## II. THE “SERIES” LANGUAGE OF THE DELAWARE ALTERNATIVE ENTITY ACTS

### A. THE DELAWARE STATUTORY TRUST ACT (DSTA)

#### 1. FORMATION OF A SERIES

Section 3806 of Title 12 of the Delaware Code provides that a governing instrument of a statutory trust may contain provisions for “classes, groups or *series of trustees or beneficial owners*, or classes, groups or series of beneficial interests, having such relative rights, powers and duties as the governing instrument may provide . . . and may make provision for future creation in the manner provided in the governing instrument of additional classes, groups or series of trustees, beneficial owners or beneficial interests, . . .”<sup>14</sup> The statute further provides that the governing instrument may establish series of trustees, beneficial interests or beneficial owners having separate rights, powers or duties with respect to separate property or obligations of the *statutory trust* or profits and losses associated with specific series.<sup>15</sup> Thus, the creation of a series in a statutory trust is found in the governing instrument of the statutory trust.

A “governing instrument” of a statutory trust is any instrument that *creates* a statutory trust or provides for the *governance* of the internal affairs and the conduct

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<sup>13</sup> The DLLCA was also amended in 1996 to add the “series” provisions. The revisions became effective August 1, 1997.

<sup>14</sup> 12 Del.C. § 3806(b)(1).

<sup>15</sup> 12 Del.C. § 3806(b)(1).

of its business.<sup>16</sup> A governing instrument:

(1) May provide that a person is entitled to become a beneficial owner or trustee if that person<sup>17</sup> satisfies whatever conditions are set forth in the governing instrument or any other writing for becoming a beneficial owner or trustee. If such conditions are met, a beneficial owner acquires a beneficial interest in the statutory trust;<sup>18</sup>

(2) May consist of one or more agreements, instruments, or other writings, including or incorporating bylaws with provisions regarding the business of the statutory trust, the conduct of its affairs as well as its rights or powers and the rights or powers of its beneficial owners, trustees, agents, or employees;<sup>19</sup>

(3) May contain other provisions that are not inconsistent with the certificate of trust or with other law.<sup>20</sup>

The DSTA does not require the statutory trust to execute its governing instrument.<sup>21</sup> In addition, a statutory trust, trustee, or beneficial owner is bound by the governing instrument whether or not the trust, trustee, or beneficial owner executes the governing instrument.<sup>22</sup>

In forming a “series” statutory trust, § 3804 of Title 12 provides that a series

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<sup>16</sup> 12 Del.C. § 3801(f).

<sup>17</sup> 12 Del.C. § 3801(f)(1)(in the case of a beneficial owner, a representative authorized by that person orally, in writing or by other action like the payment for a beneficial interest).

<sup>18</sup> 12 Del.C. § 3801(f)(1). The term “beneficial interest” is not defined in the Act; however, a “beneficial owner” is defined 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). The rights of a beneficial owner in trust property are set forth at 12 Del.C. § 3805.

<sup>19</sup> 12 Del.C. § 3801 (f)(2).

<sup>20</sup> 12 Del.C. § 3801(f)(3).

<sup>21</sup> 12 Del.C. § 3801(f).

<sup>22</sup> Id.

statutory trust, in order to receive the benefit of a limitation on liabilities attaching to segregated “series” assets, must first allocate trust property or obligations in a governing document and thereafter “link” a trustee or beneficial owner with designated rights and duties - *i.e.*, the creation of the “series.” After the series is formed, the governing instrument must set forth a method to maintain “distinct records” for the series and for the assets and any profits or losses associated with the series.<sup>23</sup> The records may be maintained directly or indirectly, including through a nominee, so long as the records reflect the independence of one series asset’s from those of another.<sup>24</sup> This formation requirement is known generally as the “records” condition.

Equally important in the formation of a series is the “notice” obligation. In order to furnish notice to third parties that the trust is segregated into limited liability “cells,” §3804(a) calls for notice of the limitation of liability of a series in the certificate of trust of the statutory trust. The notice mandate of § 3804(a) suggests that a series exist in order for notice to be required.<sup>25</sup> Thereafter, if the appropriate notice is supplied in the certificate of trust, then the debts, obligations, liabilities and expenses incurred, contracted for or otherwise existing regarding a specific series are enforceable against the assets of that series only. The debts, obligations, liabilities and expenses incurred, contracted for or otherwise existing as to the statutory trust generally or any other series are enforceable against the trust or such series respectively unless otherwise provided for in the governing instrument of the statutory trust.<sup>26</sup>

In sum, three identifiable steps are necessary to create the series: (1) the proper allocation in the governing document of property or obligations and the linkage of a trustee or beneficial owner with management and profit and loss rights;

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<sup>23</sup> 12 Del.C. § 3804(a). Section 3804 and the “records” and “notice” provisions required for the statutory trust series is entitled “Legal proceedings.” The other section of the DSTA that contains “series” provisions is § 3806, entitled “Management of statutory trust.” Thus, unlike the DLLCA, the DSTA does not contain a free-standing “series” provision.

<sup>24</sup> *Id.*

<sup>25</sup> *Compare* 6 Del.C. § 18-215(b)(“Notice in a certificate of formation of the limitation on liabilities of a series as referenced in its subsection shall be sufficient for all purposes of this subsection whether or not the limited liability company has established any series when such notice is included in the certificate of formation,...”).

<sup>26</sup> 12 Del.C. § 3804(a).

(2) a methodology for maintaining distinct and separate records of the property and obligations and profits and losses so allocated; and (3) notice of the series as created set forth in the certificate of formation of the statutory trust. With all these requirements met, the internal liability shield should be enforced against internally and against third party creditors.

## **2. MANAGEMENT OF A SERIES**

Each designated series of trustees, beneficial owners or beneficial interests may have separate rights, duties and powers regarding specified property or obligations of the statutory trust as well as profits or losses associated with specified property or obligations of the trust.<sup>27</sup> In addition, separate series may have independent business purposes or investment objectives so long as those purposes or objectives are set forth in the governing instrument of the statutory trust.<sup>28</sup>

The governing instrument has the power to grant greater rights to one series or another or to one member or manager. The profit and losses associated with a series may be varied by the operating agreement as well. In essence, the governing instrument has maximum flexibility to modify, create, reallocate or vest in the beneficial owners or trustee whatever rights or duties the parties desire. The agreement is presumptively enforceable according to the policy of the DSTA.<sup>29</sup>

## **3. SERVICE OF PROCESS**

A Delaware trustee of a statutory trust or a registered agent of the trust may be served with process in all civil actions and other proceedings brought in the State relating to the activities of the statutory trust or a violation by the trustee of its duty to the trust or to any beneficial owner, whether or not the trustee is a trustee at the time suit is brought.<sup>30</sup> Every resident or nonresident of the State who accepts appointment, election or serves as a trustee of the statutory trust is deemed to have

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<sup>27</sup> 12 Del.C. § 3806(b)(2).

<sup>28</sup> Id.

<sup>29</sup> 12 Del.C. §3825(b).

<sup>30</sup> 12 Del.C. § 3806; §3804(b); (c).

consented to the appointment of the Delaware trustee or registered agent of the trust and, as that person's agent upon whom service may be made, is deemed to have accepted service upon the Delaware trustee or registered agent as if served upon that trustee. Once process is served, defendant's opportunity to file a responsive pleading is computed by the Prothonotary or the Register in Chancery as determined from the date of mailing.<sup>31</sup>

#### 4. MANAGEMENT OF STATUTORY TRUST WITH OR WITHOUT A SERIES

Section 3806(b)(3) of the DSTA also permits the governing instrument to contain provisions regarding: 1) amendment of the governing instrument; 2) accomplishment of a merger, conversion or consolidation; 3) the appointment of one or more trustees; 4) the sale, lease, exchange, transfer . . . or other disposition of the assets of the trust or of the series; 5) the dissolution of the statutory trust; or 6) the taking of action to create a class, group or series of beneficial interests that was not previously outstanding, without the vote or approval of a trustee, beneficial owner, class, group or series of trustees or beneficial owners.

This permissive language regarding fundamental decision-making vis-a-vis the entity is absent in the LLC *series* statutory provisions. However, §3806(b)(3) may be interpreted as *non-specific* to a series but instead being directed to the *general managerial authority* of the trust. Such broad powers, if able to be accomplished solely by a *series* of beneficial interests or beneficial owners clearly would hint of a series "entity" within the DSTA. On the other hand, an explanation that interprets the "amendment/conversion" language to not be expressly linked to specific properties of a series<sup>32</sup> would suggest that any default amendment and conversion power is limited to general *managerial authority* of the *trust* rather than any authority granted to a *series*.

Section 3806(b)(4) permits the governing instrument to provide for (or withhold from) trustees or beneficial owners, or a class, group or series of trustees or beneficial owners, a right to vote, in any matter, in any manner. Section 3806(b)(5) also permits the setting of notice requirements, establishment of actions by written consent, creation of record dates, quorum requirements, or any other mandate associated with the manner or matter of the exercise of voting rights.

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<sup>31</sup> 12 Del.C. § 3804(d).

<sup>32</sup> 12 Del.C. §§ 3806 (1), (2), and (4) are explicit in their reference to a "class, group or series."

Section 3806(b)(6) provides for the present or future creation of more than one statutory trust, including the creation of a future statutory trust to which all of the assets, liabilities, profits or losses of an existing trust could be transferred and for the conversion of an existing statutory trust, or series thereof, into beneficial interests in the separate statutory trust, or series thereof.

The governing instrument of a statutory trust may provide rights to any person, including a person who is not a party to the governing instrument.<sup>33</sup> The governing instrument may also set forth the manner in which it will be amended, including requiring the consent of a party who is not a party to the governing instrument or the satisfaction of specified conditions.<sup>34</sup>

Meetings of beneficial owners<sup>35</sup> or trustees<sup>36</sup> may be held by telephonic means or other communications equipment by which all persons participating in the meeting can hear each other. Participation in this manner constitutes presence in person at a meeting.<sup>37</sup> This default rule may be modified by the governing instrument of the trust.<sup>38</sup>

The manner, matter and method of beneficial owner<sup>39</sup> and trustee<sup>40</sup> voting may be set forth in the governing instrument. Otherwise, default rules for beneficial owner and trustee action by written consent, use of proxies or proxies via electronic transmission, and the minimum number of votes necessary to take action is set forth in the DSTA.<sup>41</sup>

In a governing instrument of the statutory trust *or other writing*, a trustee or beneficial owner or other person may agree to be bound by the nonexclusive jurisdiction of the courts of, or arbitration in, a specified forum. Likewise, a trustee

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<sup>33</sup> 12 Del.C. § 3806(b)(8).

<sup>34</sup> 12 Del.C. § 3806(b)(9).

<sup>35</sup> 12 Del.C. § 3806(f).

<sup>36</sup> 12 Del.C. § 3806(g).

<sup>37</sup> 12 Del.C. § 3806(f)(g).

<sup>38</sup> Id.

<sup>39</sup> 12 Del.C. § 3806(f).

<sup>40</sup> 12 Del.C. § 3806(g).

<sup>41</sup> 12 Del.C. § 3806(f)(g).

or beneficial owner may agree to be bound to the exclusive jurisdiction of the State of Delaware or to exclusive arbitration in a specified jurisdiction, including Delaware.<sup>42</sup> In any event, a beneficial owner who is not a trustee may not waive its right to bring a legal action or proceeding in the courts of Delaware with respect to matters concerning the internal affairs of the trust.<sup>43</sup>

## 5. DISTRIBUTIONS IN A STATUTORY TRUST

A beneficial owner owns an undivided beneficial interest in the property of the statutory trust and shares 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 the beneficial owner.<sup>44</sup> A beneficial owner's beneficial interest in a statutory trust is personal property and the beneficial owner has no right or interest in specific statutory trust property.<sup>45</sup> A beneficial owner's interest is freely transferable.<sup>46</sup> Beneficial owners have no preemptive right to subscribe to additional issuances of beneficial interests in the statutory trust.<sup>47</sup>

These default rules regarding the rights of beneficial owners are subject to modification by the governing instrument of a statutory trust or the organization of the trust as a "series" trust. Thus, the "free transferability" rule may be restricted in a governing instrument and beneficial owners may be required to first offer their interests to the trust or other beneficiaries before selling to outsiders. Also, with regard to profit and loss sharing, if the trust is organized as a "series" trust, a beneficial owner's right to receive profits will be linked to the series to which the beneficial owner is "associated," and the same owner's losses will likewise be limited to the assets of the same series.

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<sup>42</sup> 12 Del.C. § 3804(e).

<sup>43</sup> Id. This rule does not come into play if the owner has otherwise agreed to arbitrate in a specified jurisdiction as well as Delaware and to the specified jurisdiction of Delaware on all other matters.

<sup>44</sup> 12 Del.C. § 3805(a)

<sup>45</sup> Id. at (c).

<sup>46</sup> Id. at (d).

<sup>47</sup> Id. at (i).

## 6. ACCESS TO AND CONFIDENTIALITY OF INFORMATION AND RECORDS

The default rule in a statutory trust is that each beneficial owner has, subject to reasonable standards as established by the trustees or as provided in a governing instrument, the right to obtain from the statutory trust: (1) a copy of the governing instrument, the certificate of trust, and all amendments, including any copies of written powers of attorney pursuant thereto;<sup>48</sup> (2) a current list of the name and last known business, residence or mailing address of each beneficial owner and trustee;<sup>49</sup> (3) information concerning the business affairs of the statutory trust, including its financial condition;<sup>50</sup> and (4) any other information concerning the business affairs of the statutory trust as is “just and reasonable.”<sup>51</sup>

In order to obtain the information under § 3819, a beneficial owner or trustee must make a “reasonable” demand in writing and must state the purpose for the demand.<sup>52</sup> The purpose of the demand must be reasonably related to the beneficial owner’s or trustee’s interest in that person’s capacity.<sup>53</sup> If a demand is made by a beneficial owner pursuant to subsection 3819(a), each trustee has the authority to examine the information listed in subsection § 3819(a) for the purpose of determining a purpose reasonably related to a trustee’s position as a trustee.<sup>54</sup> This default rule may be modified by a provision in a governing instrument.<sup>55</sup>

A trustee may keep certain information confidential from beneficial owners for a reasonable time, unless the governing instrument provides otherwise.<sup>56</sup> The types of information typically kept confidential include information: (1) the trustees

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<sup>48</sup> 12 Del.C. § 3819(a)(1).

<sup>49</sup> Id. at (a)(2).

<sup>50</sup> Id. at (a)(3).

<sup>51</sup> Id. at(a)(4).

<sup>52</sup> 12 Del.C. § 3819(e).

<sup>53</sup> 12 Del.C. §§ 3819(a); 3819(e).

<sup>54</sup> 12 Del.C. § 3819(b).

<sup>55</sup> Id.

<sup>56</sup> 12 Del.C. § 3819(c).

consider to be in the nature of trade secrets;<sup>57</sup> (2) disclosure of which, in good faith, the trustees believe to be not in the best interest or harmful to the trust;<sup>58</sup> (3) which the trustees believe could be harmful or, if disclosed, could cause damage to the trust;<sup>59</sup> or (4) which the statutory trust is required by law not to disclose or, by a commitment with a third party, not to disclose.<sup>60</sup> The records and information of a statutory trust may be maintained in written or other than written form so long as the chosen form is capable of being converted into written form.<sup>61</sup>

## 7. LIABILITY OF BENEFICIAL OWNERS AND TRUSTEES

Unless otherwise provided for in the governing instrument of the statutory trust, the beneficial owners have the same limitation of personal liability that is extended to stockholders of “private corporations for profit organized under the general corporation law of the State.”<sup>62</sup> A trustee who acts in its capacity as trustee also has no personal liability to any person other than the statutory trust or a beneficial owner for any act, omission or obligation of the statutory trust or any trustee thereof.<sup>63</sup> The latter provision is a default rule that may be modified by the governing instrument of the statutory trust.

Generally, employees, officers, managers and other persons acting as advisors to the statutory trust have the same default personal liability rule as trustees.<sup>64</sup> Pursuant to § 3807(b)(7), the governing instrument of the statutory trust may relieve these persons from personal liability for good faith reliance on the records of the statutory trust or upon information provided to them by trustees, other officers or professionals so long as the circumstances indicate that it is

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<sup>57</sup> Id.

<sup>58</sup> Id.

<sup>59</sup> Id.

<sup>60</sup> Id. at (c).

<sup>61</sup> Id. at (d).

<sup>62</sup> 12 Del.C. § 3803(a).

<sup>63</sup> Id. at (b).

<sup>64</sup> Id. at (c).

reasonable for the employee/manager/advisor to so rely on the information provided.<sup>65</sup>

## 8. MODIFICATION OF DUTIES AND LIABILITIES IN A GOVERNING INSTRUMENT

A governing instrument may expand, restrict or eliminate *duties*, including fiduciary duties, that a trustee, beneficial owner or other person may have to a statutory trust or to another trustee or beneficial owner.<sup>66</sup> The governing instrument may not eliminate the contractual covenant of good faith and fair dealing.<sup>67</sup> In addition, a trustee, beneficial owner or other person has no liability to a statutory trust, to another trustee or beneficial owner or another person that is a party to or bound by the governing instrument for breach of fiduciary duty for the trustee's, beneficial owner's, or other person's good faith reliance on provisions set forth in the governing instrument.<sup>68</sup> This default rule of non-liability of good faith reliance may be altered in the governing instrument.<sup>69</sup> By eliminating primary duties in a governing instrument, arguments for imposing *secondary liability* or liability for aiding and abetting a breach of fiduciary duty on managerial advisors become impossible.

In a parallel manner, a governing instrument may provide for the limitation or elimination of *liability* for breach of contract and breach of fiduciary duties (including fiduciary duties) of a trustee, 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 is bound by a governing instrument.<sup>70</sup> In this manner, a governing instrument may retain *duties* but limit *liability* for breach of such duties. A

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<sup>65</sup> Id. No obligation of a beneficial owner or a trustee that arises under a governing instrument or another writing or any note or other writing evidencing such an obligation of a trustee or beneficial owner shall be subject to the defense of usury and no beneficial owner or trustee may use such a defense of usury with respect to any such action. 12 Del.C. § 3803(d).

<sup>66</sup> 12 Del.C. § 3806(c).

<sup>67</sup> Id.

<sup>68</sup> 12 Del.C. § 3806(d).

<sup>69</sup> Id.

<sup>70</sup> 12 Del.C. § 3806(e).

governing instrument may not limit or eliminate liability for any conduct or inaction that constitutes a bad faith violation of the contractual covenant of good faith and fair dealing.<sup>71</sup> Unlike the above example, in this case *secondary liability* against market advisors or attorneys remains since contractual and fiduciary *duties* remain, only *liability* has been limited.

A trustee, beneficial owner or an officer, employee, manager or other person appointed, elected or engaged as an agent or independent contractor or delegate of the trustees to act as managers of the trust or to manage the affairs of the trust is fully protected in relying in good faith upon the records of the statutory trust and upon information, opinions, reports or statements presented by another trustee, beneficial owner or officer, employee, manager or other person designated to act by such persons.<sup>72</sup> To be fully protected under this provision, the person relying upon protection must reasonably believe the reports, opinions or statements are within the other person's professional expertise, including information as to the value and amount of the assets, liabilities, profits or losses of the statutory trust or other financial information regarding making reasonable provision to pay claims and obligations of the trust or other facts relative to the existence and amount of assets from which distributions to beneficial owners or creditors might be paid.<sup>73</sup>

The "good faith reliance" defense for agents or independent contractors of the trust, including officers, employees and managers, is subject to exclusion or a "carve down" by the governing instrument. However, if the "good faith" defense is available and a defendant can satisfy whatever jurisdictional test of "good faith" is being applied,<sup>74</sup> then liability protection should be absolute, *i.e.*, "fully protected" from personal liability, including a claim for aiding and abetting.

## 9. INDEMNIFICATION

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<sup>71</sup> Id.

<sup>72</sup> 12 Del.C. § 3806(k).

<sup>73</sup> 12 Del.C. § 3806(k).

<sup>74</sup> *In re Walt Disney Co., Derivative Litigation*, 2005 Del.Ch. LEXIS 113, (Aug. 9, 2005) ("conscious disregard for one's responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith. Deliberate indifference and inaction in the face of a duty to act is conduct that is clearly disloyal to the corporation. It is the epitome of faithless conduct.").

Depending upon any restrictions or limitations provided for in the governing instrument of a statutory trust, a trustee, beneficial owner or other person may be indemnified or held harmless by a statutory trust from any and all claims or demands whatsoever.<sup>75</sup> The fact that a governing instrument is silent regarding indemnification is not to be construed to deny a trustee, beneficial owner or another person of any right to indemnification which is otherwise available to such person under the laws of the State of Delaware.<sup>76</sup>

## 10. PERPETUAL EXISTENCE OF STATUTORY TRUST

The default rule for a statutory trust is that the trust has perpetual existence and that the trust may not be terminated or revoked by a beneficial owner or another person except in accordance with the terms of its governing instrument.<sup>77</sup> The default rule thus includes the death, dissolution, incapacity, bankruptcy or termination of a beneficial owner unless the governing instrument expressly provides that such circumstances affirmatively cause the termination or dissolution of the trust.<sup>78</sup>

A statutory trust may be organized or formed with the purpose that it does not have perpetual existence. If a trust does not have perpetual existence, the trust is dissolved and its affairs wound up upon the happening of events specified in its governing instrument.<sup>79</sup> A statutory trust without perpetual existence need not dissolve and wind up its affairs if, prior to the filing of a certificate of cancellation and effective as of the happening of the specified event, an affirmative vote or written consent of all remaining beneficial owners or other person necessary to approve votes in favor of continuance.<sup>80</sup>

In the period between the dissolution of the trust and the filing of a certificate

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<sup>75</sup> 12 Del.C. § 3817(a).

<sup>76</sup> Id. at (b).

<sup>77</sup> 12 Del.C. § 3808(a).

<sup>78</sup> Id. at (b).

<sup>79</sup> 12 Del.C. § 3808(c).

<sup>80</sup> Id. This provision will not work if the dissolution was caused by a vote or written consent unless the persons who voted or consented to the dissolution reverse direction and vote or consent instead to a continuance of the trust. Id.

of cancellation of the trust, the persons with the authority under the governing instrument to wind up the trust affairs may prosecute and defend suits, settle and close the business of the trust, discharge or make reasonable provision for the statutory trust liabilities and thereafter distribute to the beneficial owners any remaining assets of the statutory trust.<sup>81</sup>

A dissolved statutory trust must: “pay or make reasonable provision to pay all obligations and claims, including all contingent, conditional or unmatured claims and obligations, which are known to the statutory trust but for which the identity of the claimant is unknown and claims and obligations that have not been made known to the statutory trust or that have not arisen but that, based on the facts known to the statutory trust, are likely to arise or to become known to the statutory trust within 10 years after the date of a dissolution.”<sup>82</sup> If assets are sufficient, all claims and obligations are to be paid in full.<sup>83</sup> If assets are insufficient, claims and obligations are to be paid or provided for according to priority and, among claims and obligations of equal priority, ratably to the extent available.<sup>84</sup> Unless otherwise provided, all remaining assets are to be distributed to the beneficial owners.<sup>85</sup> Any person who, under the governing instrument of the statutory trust, complies with this section has no personal liability to the claimants of the dissolved statutory trust by reason of such person’s actions in winding up the statutory trust.<sup>86</sup>

## 11. FOREIGN STATUTORY TRUSTS

Before doing business in the state, a foreign statutory trust must register with the Secretary of State. A copy of the registration must be executed by a trustee and must contain: (1) the name of the statutory or the name under which it proposes to do business; (2) the jurisdiction of formation and a statement from a trustee or other authorized person that the statutory trust validly exists; (3) the nature or purpose of

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<sup>81</sup> 12 Del.C. § 3808(d).

<sup>82</sup> 12 Del.C. § 3808(e).

<sup>83</sup> Id.

<sup>84</sup> Id.

<sup>85</sup> Id.

<sup>86</sup> 12 Del. C. § 3808(e).

the business to be conducted in the state; (4) the address of the registered office and the name and address of the registered agent for service of process; (6) a statement that the Secretary of State is appointed the agent of the trust for service of process under certain circumstances; and (7) the date on which the foreign statutory trust first intends to do business.<sup>87</sup>

The laws of the jurisdiction under which a foreign statutory trust is organized govern its organization, internal affairs, and the liability of its beneficial owners and trustees.<sup>88</sup> A foreign statutory trust may not be prevented from filing a doing business registration on the basis of any difference between its governing laws and the laws of the state of Delaware.<sup>89</sup> Unlike the DLLCA, however, a foreign series statutory trust is not required to specifically mention the fact and nature of the series limitation.

The question that is presented is whether a foreign statutory trust that registers to do business will have its internal shields recognized by a Delaware court and, conversely, whether a Delaware series statutory trust will have its series shields recognized in a jurisdiction that does not have enabling series legislation. As to the first question, it would appear that the “doing business” registration is not intended to unconditionally grant recognition to all series entities. On the other hand, as a matter of comity, a Delaware court is likely to look to the law of the jurisdiction of formation, including governing law that establishes series. As to case law on point regarding the series, in *G x G Management LLC v. Young Brothers and Co., Inc.*,<sup>90</sup> a Maine court faced with a Delaware series LLC did not hesitate to interpret Delaware law governing the series despite the fact that Maine has no enabling series statute.<sup>91</sup>

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<sup>87</sup> 12 Del.C. § 3852(a)(1).

<sup>88</sup> 12 Del.C. § 3851(1).

<sup>89</sup> 12 Del. C. § 3851(2).

<sup>90</sup> 2007 WL 1702872 (D.Me. 2007).

<sup>91</sup> *But see Butler v. Adoption Media, LLC*, 2005 WL 2077484 (N.D. Cal. 2005)(court read a reference to “internal affairs and the liability and authority of its managers and members” to mean the “internal affairs doctrine” which, to the California court, did not include creditor suits against the entity.).

## 12. DUAL STATUS; DOMESTICATION OR TRANSFER OF NON-UNITED STATES ENTITIES

The DSTA permits a non-United States entity<sup>92</sup> to domesticate as a statutory trust in Delaware and continue its existence in the foreign country or other foreign jurisdiction in the same manner as it was immediately prior to domestication as a statutory trust in Delaware.<sup>93</sup> If a foreign entity chooses “dual status” under § 3822, the domesticating foreign entity and the continuing foreign entity constitute a single entity created or formed under the laws of Delaware and the laws of the foreign jurisdiction.<sup>94</sup>

The reverse transaction is also permitted in Delaware. A Delaware statutory trust may transfer to or domesticate in any jurisdiction other than another state and continue its existence in Delaware.<sup>95</sup> The transferring or domesticating Delaware entity continues its existence in Delaware and the new entity formed or created in the foreign jurisdiction constitute a single entity under the laws of Delaware and the laws of the jurisdiction under which the new entity was formed or created.<sup>96</sup>

The approval necessary to undertake a domestication and continuance is that set forth in the document or writing governing the internal affairs of the non-US entity or by applicable non-Delaware law, where appropriate.<sup>97</sup> A governing instrument must be approved by the authorization required to approve the domestication.<sup>98</sup> A transfer and continuance must be approved: (1) as set forth in

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<sup>92</sup> A non-United States entity means a foreign statutory trust (other than one formed under the laws of a state), or a corporation, a limited liability company, a business trust, a common-law trust, a real estate investment trust, or any other unincorporated business, including a partnership (whether general (including a limited liability partnership) or limited (including a limited liability limited partnership)), formed, incorporated, created or that otherwise came into being under the laws of any foreign country or other foreign jurisdiction (other than any state). 12 Del.C. § 3822(a).

<sup>93</sup> 12 Del.C. § 3822(i).

<sup>94</sup> Id.

<sup>95</sup> 12 Del.C. § 3823.

<sup>96</sup> Id. at §3823(e).

<sup>97</sup> 12 Del.C. § 3822(g)(approval for domestication).

<sup>98</sup> Id.

the governing instrument; (2) if the governing instrument is silent, then according to a provision for merger so long as a transfer and continuance is not prohibited in the governing document; (3) if the governing instrument does not have a provision for a merger and does not prohibit a transfer and continuance, then by approval of all beneficial owners and trustees.<sup>99</sup>

## **B. THE DELAWARE LIMITED LIABILITY COMPANY ACT**

Delaware amended the DLLCA in 1996, effective 1997, to include a “series” provision.<sup>100</sup> The amendment is entitled: “Series of members, managers or limited liability company interests.” Unlike its counterpart in the Delaware Statutory Trust Act, the DLLCA series amendment found at § 18-215 is a stand-alone provision. This independent provision: 1) references “class and groups” of members or managers that may be associated with a series for purposes of voting rights; 2) creates a statutory provision for a “series” of members, managers and limited liability company interests independent of the Act’s default managerial section; 3) creates a “records and notice” system so that “debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing”<sup>101</sup> of separate series are enforceable only against that series (a limitation on liabilities); and 4) provides for the future creation of classes or groups of members or managers, including a class or group of the series of LLC company interests that was not previously outstanding. Also, in the 2006 amendments to the DLLCA, the term “series” was added to the definition of “person” at §18-101(12) so that “person” now includes: “...or any other individual or entity (*or series thereof*) in its own or any representative capacity . . . ”<sup>102</sup>

The 2007 amendments to the DLLCA made several changes that will be addressed within the body of the discussion.

### **1. FORMATION OF THE SERIES**

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<sup>99</sup> 12 Del.C. § 3823(b).

<sup>100</sup> 6 Del.C. § 18-215. Certain re-numbering of DLLCA will result from the 2007 amendments, effective August 1, 2007. The re-numbering is not reflected in this piece.

<sup>101</sup> 6 Del.C. § 18-215(b).

<sup>102</sup> 6 Del.C. § 18-101(12).

The core stages of formation according to § 18-215(b) are: (1) the allocation of LLC property, obligations or assets and a subsequent allocation in the operating agreement of a member, manager or membership interest with managerial authority and rights to receive profits and losses from such property in whatever manner desired; (2) a method set forth in the operating agreement to maintain separate and distinct records concerning the allocation of the LLC property, profits, losses or other distributions of whatever nature; and (3) a notice of the limitation on liabilities set forth in the certificate of formation of the limited liability company. Examining § 18-215(b) further, the essence of the DLLCA series is “separateness.”

In the 2007 amendments to § 18-215(b), the “records” language was modified to make clear that the term “records” include documents of whatever nature, so long as the records “reasonably identify its [the series] assets, including by specific listing, category, type, quantity, computational or allocational formula or procedure (including a percentage or share of any asset or assets) or by any other method where the identity of such assets is objectively determinable . . . .”<sup>103</sup> The purpose of the 2007 amendments was simply to clarify that the character or *nature* of the record was not as important as its *function* in identifying segregated assets in an objectively determinable manner.

A second core stage in creating a Delaware LLC series is a “notice” requirement. In order for the “separateness” of a series to be enforceable and the limitation of liability confined to single series, § 18-215(b) demands that “notice” of the series be included in a certificate of formation of the limited liability company. “Notice in a certificate of formation of the limitation on liabilities of a series *as referenced in this subsection*”<sup>104</sup> is considered sufficient, whether or not a series is created at the time the LLC is formed.<sup>105</sup> Further, the notice mandated by § 18-215(b) does not require reference to any specific series, unlike the series in a Delaware statutory trust. Note also that the “notice” language of the LLC series is

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<sup>103</sup> Amendments to § 18-215(b), SB 95, 96. Effective Aug. 1, 2007. 70 Del. Laws, c. 360, §9, 70 Del. Laws, c. 186, §1, 71 Del. Laws, c. 77, §§ 19-23, 71 Del. Laws, c. 341, §§ 9, 10, 72 Del. Laws, c. 389, §§ 14-18; 74 Del. Laws, c. 85; §§ 12, 13; 74 Del. Laws, c. 275, § 9.

<sup>104</sup> *Id.*

<sup>105</sup> The fact that a series does not have to be in existence at the time “notice” of the series is provided for in the certificate of formation allows the creation of what is known as a “shelf” series - i.e., a blank series that may be “filled in” at a later date according to the limited liability agreement of the company.

somewhat different from that of the statutory trust series. The statutory trust notice concerning a series set forth at § 3804(a) refers to notice of “debts, obligations . . . with respect to a particular series.” With the 2007 amendments to DLLCA, a series may be created with an allocation of LLC “assets” as well. There is also no stated allowance for providing notice for trust series that are yet to be formed pursuant to the DSTA.

The third core stage in the development of the series is the culmination of the first two - a limitation on liabilities that attaches to the assets or property of a series that is formed in compliance with the “notice” and “records” requirements of § 18-215(b). Thus, if the first two core elements are established, the limitation on liability protection of the series is enforceable against third parties.

In order to complete the formation of a Delaware series LLC, a certificate of formation must provide a “notice” or reference to a series whether or not the series is yet in existence. The specificity of the series reference is not explicit in the statute, yet good practice suggests clear expression of a series and the limitation upon liability. Thereafter, with the maintenance of separate and distinct records for each series, the liability limitation concept of the series should be enforced by the courts.

## **2. SERVICE OF PROCESS**

A manager or a liquidating trustee of an LLC may be served with process in all civil actions or proceedings in the State of Delaware involving the business of the LLC or a violation of the manager or liquidating trustee of a duty to the LLC.<sup>106</sup> A member may also be served with process, whether or not the manager or the liquidating trustee is a manager or a liquidating trustee at the time suit is commenced.<sup>107</sup> If a manager or liquidating trustee acts in such capacity, the trustee or manager consents that the resident agent of the LLC is such person’s agent for purpose of service of process upon that person.<sup>108</sup> Once service has been made, responsive filings are processed through the Secretary of State, the Prothonotary and the Register in Chancery.<sup>109</sup> These same rules would apply to a manager or

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<sup>106</sup> 6 Del.C. § 18-109(a).

<sup>107</sup> Id.

<sup>108</sup> Id.

<sup>109</sup> Id.

liquidating trustee of a series in liquidation.

In a written operating agreement or other writing, a member or manager may agree to be bound by the nonexclusive jurisdiction of the courts of, or arbitration in, a specified jurisdiction.<sup>110</sup> Alternatively, a member or manager may consent to be bound by the exclusive jurisdiction of the courts of Delaware or to the exclusivity of arbitration in a specified jurisdiction or in Delaware.<sup>111</sup> However, a member who is not a manager may not waive its right to sue in the courts of Delaware with respect to matters involving the internal affairs of the LLC.<sup>112</sup>

### **3. POWER AND AUTHORITY OF SERIES**

In addition to the new language at subsection (b), a new subsection (c) was added by the 2007 amendments to § 18-215. New § 18-215(c) provides:

A series established in accordance with subsection (b) of this section may carry on any lawful business, purpose or activity, whether or not for profit, with the exception of the business of banking as defined in § 126 of Title 8. Unless otherwise provided in a limited liability company agreement, a series established in accordance with subsection (b) of this section shall have the power and capacity to, in its own name, contract, hold title to assets (including real, personal and intangible property), grant liens and security interests, and sue and be sued.<sup>113</sup>

Under the 2007 amendments, therefore, the “person” defined as a “series” has the capacity to contract in its own name, hold title to real estate and assets, sue and be sued, and create security interests and grant liens. The nature of that “person,” however, appears to be derivative of the entity whose property it holds, *i.e.*, the LLC.<sup>114</sup>

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<sup>110</sup> 6 Del.C. § 18-109(d).

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* This exception is not applicable if the parties have agreed to arbitrate in Delaware

<sup>113</sup> 6 Del.C. § 18-215(c) as amended by SB 95, 96. Effective August 1, 2007.

<sup>114</sup> *See* discussion at III B.

#### **4. MANAGEMENT OF LLC WITH A SERIES OR MANAGEMENT OF A SERIES**

Once a basic series is formed, § 18-215 permits the creation of “classes or groups” of members or managers associated with a series “having such rights, powers and duties” as contracted for in the limited liability company agreement, including the creation of future groups or classes associated with a series having rights that are senior to those already in existence.<sup>115</sup> The LLC agreement may also provide for the amendment of the company operating agreement “without the vote or approval of any member or manager or class or group of members or managers,”<sup>116</sup> including the creation of a class or group of the series of LLC interests that did not previously exist. The LLC agreement may also provide that any member or class or group of members associated with a series have no voting rights.<sup>117</sup> Voting by members or managers may be separately or with all or any class or group of members or managers associated with a series and may be on a per capita, number, financial interest, group, class or other agreed upon basis.<sup>118</sup> Thus, the operating agreement of the LLC has the power to provide for any management rights or duties to vest in members or managers or both in whatever manner agreed upon.

In the absence of an agreement, management of a series is vested in the members according to the then current percentage or other interest of the members in the profits of the series owned by the members associated with the series.<sup>119</sup> Members owning more than 50% of the profits control the decision-making of the series in the absence of an agreement to the contrary. If a manager is appointed to manage the series, management is conducted as set forth in the LLC agreement. Termination of a manager likewise will follow as set forth in the LLC agreement. Unless otherwise provided in the LLC agreement, termination of a manager in one series does not, in itself, terminate the manager in another series or as manager of

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<sup>115</sup> 6 Del.C. § 18-215(d).

<sup>116</sup> Id.

<sup>117</sup> Id.

<sup>118</sup> 6 Del.C. § 18-215(e).

<sup>119</sup> Id. at § 18-215(f).

the LLC itself.<sup>120</sup>

## 5. DISTRIBUTIONS IN A SERIES

Distributions with respect to a series are made in accordance with the terms of the LLC agreement. However, distributions shall not be made to the extent that, after giving effect to the distribution,<sup>121</sup> all liabilities of the series exceed the fair value of the assets of the series, except that the fair value of the series' property that is subject to a liability for which the recourse of creditors is limited will only be included in the assets to the extent that the fair value of that property exceeds that liability.<sup>122</sup> The term "distribution" as used in § 18-215(h) does not include "reasonable compensation for present or past services,"<sup>123</sup> or "reasonable payment made in the ordinary course of business pursuant to a bona fide plan or other benefits program."<sup>124</sup> If a member receives a distribution in violation of § 18-215(h) knowing at the time of the distribution that it was wrongful, the member is liable to the series for the amount of the distribution.<sup>125</sup> If a member is under an agreement to pay, that agreement prevails whether or not the member had knowledge of a wrongful distribution. Generally, actions not brought within three years of a distribution preclude recovery from a member who received a distribution.<sup>126</sup>

## 6. ASSIGNMENT OF INTERESTS IN A SERIES

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<sup>120</sup> Id.

<sup>121</sup> This amount does not include liabilities to members on account of their LLC interests with respect to the series or liabilities of creditors whose recourse is limited to specified property of the series. 6 Del.C. § 18-215(h).

<sup>122</sup> Id.

<sup>123</sup> Id.

<sup>124</sup> Id.

<sup>125</sup> Id. There is no liability for a member who has no knowledge of the wrongfulness of the distribution at the time it is made. Id.

<sup>126</sup> Id. *See also* § 18-607(c).

If a member assigns all the member's limited liability company interest with respect to a series, that member ceases to be a member of the series unless provided otherwise in the LLC agreement.<sup>127</sup> If the member is the last member of the series, the default rule is that the series is not terminated by the cessation of the member, unless provided for by the operating agreement.<sup>128</sup> In addition, the termination of the member as to one series does not, by itself, cause the member to cease being a member of another series or of the LLC itself.<sup>129</sup> These provisions set forth default rules that may be modified by the parties to the limited liability company agreement.

## 7. NATURE OF LIMITED LIABILITY COMPANY INTEREST; ASSIGNMENT OF LLC INTEREST

An interest in an LLC is personal property and grants no right in specific property of the limited liability company.<sup>130</sup> Thus, for example, if member A contributes \$50,000 to an LLC and member B contributes real estate worth \$100,000, the limited liability company now owns property worth \$150,000 and members A and B respectively own "interests" in the **LLC - not the property of the LLC**. It is the right of the members to determine their respective "profits and loss interests" in the LLC. If the members fail to do so, profits and losses will be allocated on the basis of the agreed value (as provided in the company records) of the contributions made by each member to the extent the contribution has been received by the LLC and not been returned.<sup>131</sup> In this manner, if A and B did not independently agree to profit and loss sharing and the LLC had \$75,000 to distribute, A would receive \$25,000 and B would receive \$50,000.

If A assigned her interest to her daughter, D, D would have no right to participate in the management of the LLC except as provided in the agreement of

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<sup>127</sup> 6 Del.C. § 18-215(i).

<sup>128</sup> Id.

<sup>129</sup> Id.

<sup>130</sup> 6 Del.C. § 18-701.

<sup>131</sup> *See, e.g.*, 6 Del.C. § 18-503.

the company: and (1) unanimous consent of the remaining members;<sup>132</sup> (2) compliance with any other procedure set forth in the operating agreement.<sup>133</sup> In addition, an assignment does not grant member rights to an assignee.<sup>134</sup> Instead, an assignee is only entitled to receive the distributions or allocations of income, gains, loss or similar item to which the assignor was entitled.<sup>135</sup> Once an assignment is made, a member ceases to be a member and ceases to have the authority to exercise any power as a member.<sup>136</sup> If the assignment is solely structured as a pledge, a grant of a security interest, a lien or similar encumbrance against the LLC, interest, the member does not cease to be a member unless otherwise provided in the limited liability company agreement.<sup>137</sup> Further, restrictions on assignments of LLC interests are enforceable in Delaware despite contrary provisions in the UCC.<sup>138</sup>

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<sup>132</sup> 6 Del.C. § 18-702(a)(1).

<sup>133</sup> *Id.* at (a)(2).

<sup>134</sup> 6 Del.C. § 18-702(1). *See Eureka VIII LLC v. Niagara Falls Holdings LLC*, 899 A.2d 95, 117 (Del.Ch. June 6, 2006) (“The policy that underlies subdivision (b)(3) of this section is that it is far more tolerable to have to suffer a new passive co-investor one did not choose than to endure a new co-manager without consent. That is particularly the case where, as here, an LLC is closely held. When an LLC is closely held, members often work closely with co-owners and, therefore, prefer to select their associates. Transfers of membership interests, then introduce potential new conflicts of interest and change and perhaps complicate decision-making.”). (“Thus, the statutes reinforce the remedial conclusions clearly suggested by the provisions of the LLC agreement in the instant case that were breached: plaintiff should not be bound to manage and operate an LLC with a co-member with which it never intended or agreed to go into business. To redress the situation plaintiff finds itself in, it is appropriate that defendant be remitted to holding merely the economic interest of an assignee of a members’ interest in the redevelopment company.”) *Id.* at 117.

<sup>135</sup> 6 Del.C. § 18-702(2). A provision in an LLC agreement was ruled to be an ipso facto clause vis-a-vis an assignee such that the default rules granting assignee distribution rights under § 18-702(2) governed. *Northrop Gruman Tech Servs. v. Shaw Group Inc. (In re IT Group, Inc.)*, 302 B.R. 483 (D.Del. 2003). *See also Milford Power Co., LLC v. PDC Milford Power, LLC*, 866 A.2d 738 (Del.Ch. 2004).

<sup>136</sup> 6 Del.C. § 18-702(3).

<sup>137</sup> 6 Del.C. § 18-702(3).

<sup>138</sup> 6 Del.C. § 18-1101(g) (Delaware has specifically enacted provisions in its alternative entity acts stating the §§ 9-406 and 9-408 of the UCC do not apply to interests in LLCs and

A judgment creditor of a member or of a member's assignee may apply to the Court of Chancery<sup>139</sup> for a charging order against the interest.<sup>140</sup> If the interest is charged, the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise have been entitled to receive with respect to the limited liability company interest.<sup>141</sup> The charging order is the *exclusive remedy*<sup>142</sup> for a judgment creditor of a member or of a member's assignee and no creditor has any right to obtain *possession of the property*<sup>143</sup> of the limited liability company. Stated differently, the charging order does not entitle the judgment creditor to be substituted for, or stand in the shoes of, the member whose interest is so charged. The latter rule follows because the LLC, like its partnership counterparts, is a contractual entity that permits its owners to choose with whom they desire to do business.

## 8. TERMINATION AND WINDING UP OF A SERIES

A series may be terminated without causing the dissolution of the limited liability company and does not affect the limitation on liabilities of such series.<sup>144</sup> A series is terminated and its affairs wound up upon the dissolution of the LLC or upon the first to occur of the following: 1) a time set forth in the LLC agreement;<sup>145</sup> 2) the happening of an event specified in the company agreement;<sup>146</sup> 3) upon the affirmative vote or written consent of the members or class or group of members associated with the series who own more than two-thirds of the then-current

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partnerships).

<sup>139</sup> The Court of Chancery has jurisdiction to hear matters involving charging orders. 6 Del.C. § 18-703(f).

<sup>140</sup> 6 Del.C. § 18-703.

<sup>141</sup> Id.

<sup>142</sup> Id. at (d).

<sup>143</sup> Id. at (e).

<sup>144</sup> 6 Del.C. § 18-215(j).

<sup>145</sup> 6 Del.C. § 18-215 (j)(1).

<sup>146</sup> 6 Del.C. § 18-215(j)(2).

percentage or other interest in the profits of the series of the LLC;<sup>147</sup> or 4) the termination of the series by the Court of Chancery whenever it is not reasonably practicable to carry on the business of the series in conformity with the LLC agreement.<sup>148</sup> An LLC agreement may alter the rules for termination as well as the vote necessary to cause the termination of a series.<sup>149</sup>

Unless otherwise provided in an LLC agreement, a series may be wound up by: 1) a manager associated with a series who has not wrongfully terminated the series; or if none; 2) the members associated with the series; 3) a person approved by the members associated with the series; 4) by each class or group associated with the series; 5) by members who own more than 50% of the then current percentage or other interest in the profits of the series of all the members associated with the series; or 6) by the members in each class or group associated with the series as appropriate.<sup>150</sup> Upon a showing of cause, the Court of Chancery may wind up the affairs of a series and appoint a liquidating trustee upon the application of any member associated with a series, the member's personal representative or assignee.<sup>151</sup> The persons winding up the affairs of the series may, in the name, and on behalf of, the limited liability company and the series, take all actions necessary to settle and close the series' business, including providing for the claims and obligations of the series and distributing series assets as provided for in the DLLCA.<sup>152</sup> Actions taken pursuant to §18-215(k) and §18-804 to wind up the series will not affect the liability of members or impose liability on a liquidating trustee.<sup>153</sup>

## **9. FOREIGN LIMITED LIABILITY COMPANIES WITH A SERIES**

If a foreign limited liability company registering to do business in Delaware

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<sup>147</sup> 6 Del.C. § 18-215(j).

<sup>148</sup> 6 Del. C. §§ 18-215(j)(4) and (l).

<sup>149</sup> 6 Del. C. § 18-215(j).

<sup>150</sup> 6 Del.C. § 18-215(k).

<sup>151</sup> Id.

<sup>152</sup> Id.

<sup>153</sup> Id.

is governed by an operating agreement that establishes designated series of members, managers, LLC interests, or assets<sup>154</sup> having separate rights, powers, or duties with respect to specified property or obligations of the foreign limited liability company or profits and losses associated with specified property or obligations of the LLC, that fact must be stated on the application for registration as a foreign LLC.<sup>155</sup> In addition, the foreign LLC will state on the application whether the debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a particular series is enforceable only against the assets of that series and not against the assets of the foreign LLC generally or any other series thereof and whether any of the obligations, debts, expenses and liabilities of the limited liability company generally or another series thereof are enforceable against that series.<sup>156</sup>

The question arises whether subsection 18-215(n) is a notice requirement for foreign series LLC's doing business in Delaware or whether the subsection is intended to provide substantive recognition of foreign series LLCs. Typically, foreign registrations serve the purpose of providing notice to the domestic jurisdiction of the presence of the foreign entity as well as the nature and form of that entity. As a matter of comity, courts generally recognize the organic law of the jurisdiction under which an entity is created, formed, or otherwise comes into existence. This theory, commonly known as the "internal affairs doctrine," governs the affairs of the entity, its owners and managers inter se. However, application of the internal affairs doctrine generally does not extend into the rights of third parties against the entity. For example, it seems unlikely that § 18-215(n) serves the purpose of requiring a Delaware court to recognize an Illinois series LLC solely because of a registration under subsection. § 18-215(n). However, principles of comity strongly suggest that a Delaware court would apply the governing law of a foreign entity independent of the failure of that entity to register to do business in Delaware, (at least where that foreign entity is a defendant in a Delaware court.). As to the contrary question - whether a non-Delaware court would recognize the Delaware series where the foreign jurisdiction has no enabling series legislation - one case has answered in the affirmative. In *G x G Management LLC v. Young*

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<sup>154</sup> The term "assets" was added with the 2007 amendments to §18-215(m), now § 18-215(n).

<sup>155</sup> 6 Del.C. § 18-215(m).

<sup>156</sup> Id.

*Brothers and Co., Inc.*,<sup>157</sup>

## 10. MODIFICATION OR ELIMINATION OF DUTIES AND LIABILITIES IN AN LLC AGREEMENT

Section 18-1101(b) states the general policy of the DLLCA that the principle of freedom of contract is to be given “maximum effect.”<sup>158</sup> It is also the policy of the DLLCA to enforce limited liability company agreements.<sup>159</sup>

Members of limited liability company agreements in Delaware have the right to expand, restrict or limit duties (including fiduciary duties) to an LLC or to another member, manager, or another person that is a party to or is otherwise bound by the company agreement.<sup>160</sup> The operating agreement may not eliminate the implied covenant of good faith and fair dealing.<sup>161</sup>

In addition, a member, manager or other person is not liable to an LLC or to another member, manager or another person that is a party to a limited liability company agreement for breach of fiduciary duty for the member’s, manager’s or other person’s good faith reliance on provisions of the company’s operating agreement.<sup>162</sup> The exculpation under subsection 1101(d) is for liability for breach of a fiduciary duty, not the elimination of that duty.

As for contract liability, subsection 1101(e) provides that an operating agreement may limit or eliminate all *liabilities* for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company or to another member, manager or other person that is bound to an LLC agreement.<sup>163</sup> The operating agreement may not limit or eliminate *liability* for any bad faith violation of the implied duty of good faith and fair

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<sup>157</sup> 2007 WL 1702872 (D.Me. 2007).

<sup>158</sup> 6 Del.C. § 18-1101(b).

<sup>159</sup> *Id.*

<sup>160</sup> 6 Del.C. § 1101(c).

<sup>161</sup> *Id.*

<sup>162</sup> 6 Del.C. § 1101(d).

<sup>163</sup> 6 Del.C. § 1101(e).

dealing.<sup>164</sup>

In sum, a Delaware operating agreement may eliminate all traditional fiduciary duties such as the duties of care and loyalty. By doing so, liability to the primary actor (member, manager or other person to the agreement) will not attach and secondary liability of advisors, such as attorneys, accountants, banks, investment advisors and the like, will also not attach under any theory of aiding and abetting where liability of the primary actor is required.

If an operating agreement is silent as to modifications of fiduciary duties, members, managers and other persons bound by the company agreement have no *liability* to the LLC or to each other where the members, managers and such other persons rely in good faith on provisions of the LLC agreement.<sup>165</sup> Under this provision, all duties remain intact, including contractual and fiduciary duties.

As an alternative to the limitation or outright elimination of all *fiduciary duties*,<sup>166</sup> members may choose to limit or eliminate *all liabilities* for breach of contract or breach of duty (including fiduciary duty) of members, managers or other persons that are bound by the operating agreement to the LLC or among each other.<sup>167</sup> Under this alternative, a primary actor may escape liability for a breach of a duty but an advisor or other “secondary party” could be found liable as an aider or abettor since the “duty” remains intact.

Any of the modifications or eliminations of duties and/or liabilities that may be accomplished for a “standard” LLC may also be attained in a “series” LLC through the operating agreement. In this manner, the operation of traditional fiduciary duties is likely “separated” in the same manner as the assets, property, and management of the property. Stated differently, the “series” adds another dimension to the application of the modification of duties and liabilities in Delaware unincorporated entities.

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<sup>164</sup> Id.

<sup>165</sup> 6 Del.C. § 1101(d). The operating agreement may have provisions to the contrary, with the result that members, managers and other person bound by the agreement have liability to the LLC and/or to each other.

<sup>166</sup> The contractual duty of good faith and fair dealing may not be limited or eliminated. 6 Del.C. § 1101(c).

<sup>167</sup> 6 Del.C. § 1101 (e). There is no exculpation for a bad faith violation of the implied duty of good faith and fair dealing.

## **11. GOOD FAITH RELIANCE ON STATEMENTS AND OPINIONS IN WINDING UP**

A member, manager or liquidating trustee of a Delaware LLC is fully protected in relying in good faith upon information, opinions, statements or reports presented by another member, manager, liquidating trustee, officer or employee of the LLC, committees of the LLC, members or managers, or any other person as to issues the member, manager or liquidating trustees reasonably believe to be within such person's professional competence or expertise.<sup>168</sup> The information included under the "good faith" umbrella consists of, "information, opinions, reports or statements as to the value and amount of the assets, liabilities, profits or losses of the [LLC], or the value and amount of assets or reserves or contracts, agreements or other undertakings that would be sufficient to pay claims and obligations of the [LLC] or to make reasonable provision to pay such cash and obligations, or any other facts pertinent to the existence and amount of assets from which distributions to members or creditors might properly be paid."<sup>169</sup> Section 18-406 thus provides additional protection from liability for members, managers or persons acting as liquidating trustees where those persons reasonably rely in good faith upon the professional statements and opinions of experts during the winding up or liquidation of the LLC business or the business of a series.

## **12. INDEMNIFICATION**

A limited liability company agreement may set forth any standards or restrictions regarding indemnification.<sup>170</sup> Consequently, an operating agreement may provide that any member or manager or other person may be indemnified and held harmless against any and all claims and demands of whatever nature.<sup>171</sup> The authority granted under § 18-108 includes the advancement of legal fees to a former manager in a current manager's action for breach of contract and breach of

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<sup>168</sup> 6 Del.C. § 18-406.

<sup>169</sup> Id.

<sup>170</sup> 6 Del. C. § 18-108.

<sup>171</sup> Id.

fiduciary duty.<sup>172</sup> The terms “indemnify and hold harmless” is a legal term of art that does not include the unique concept of advancement of fees.<sup>173</sup> The public policy in Delaware for the advancement of legal fees is one rooted in the fundamental tenet of freedom of contract in limited liability company agreements.<sup>174</sup>

### **13. DUAL STATUS; DOMESTICATION OR TRANSFER OF NON-UNITED STATES ENTITIES**

As with the statutory trust, the DLLCA provides that a non-United States entity may domesticate in Delaware as a limited liability company and continue its existence in the foreign jurisdiction as it did prior to domesticating in Delaware.<sup>175</sup> If the domesticating foreign entity elects “dual status,” the domesticating entity and the continuing foreign entity constitute a single entity formed or created under the laws of Delaware and the laws of the foreign jurisdiction. The approval necessary for the transaction is that “manner provided for by the document, instrument, agreement or other 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.”<sup>176</sup>

The opposite transaction is also available for transferring Delaware limited liability companies. Pursuant to §18-213, a Delaware LLC may transfer to a non-United States jurisdiction and simultaneously elect to remain a Delaware LLC. If this “dual status” election is pursued, the remaining Delaware entity and the transferred non-US entity constitute a single entity governed by the laws of Delaware and the laws of the foreign jurisdiction to which the Delaware entity transferred.<sup>177</sup>

Approval of these transactions is: (1) as set forth in the LLC agreement; (2) if

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<sup>172</sup> *Senior Tour Players 207 Mgt. Co., LLC v. Golftown 207 Holding Co., LLC*, 853 A.2d 124 (Del.Ch. 2004).

<sup>173</sup> *Majkowski v. Am. Imaging Mgt. Servs., LLC*, 913 A.2d 572, 2006 Del.Ch. LEXIS 204 (Dec. 6, 2006).

<sup>174</sup> *Id.*

<sup>175</sup> 6 Del.C. § 18-212.

<sup>176</sup> *Id.* at § 18-212(c)(6).

<sup>177</sup> *Id.* at § 18-213(i).

not so specified in the agreement and the transfer or domestication and continuance is not prohibited in the agreement, then in the same manner as a merger or consolidation; (3) if a merger or consolidation is not specified and a transfer or domestication and continuance is not prohibited, then by the majority agreement of the members by their then current percentage interest in profits.<sup>178</sup>

## **C. THE DELAWARE REVISED UNIFORM LIMITED PARTNERSHIP ACT**

### **1. AUTHORITY AND FORMATION**

Section 17-218 of the DRULPA allows the creation of a series in a Delaware limited partnership.<sup>179</sup> The limited partnership series permits the creation of one or more series of limited partners, general partners or partnership interests having separate rights powers or duties with respect to designated limited partnership property or obligations.<sup>180</sup> The series may also be created with respect to partnership profits or losses associated with specified limited partnership property or obligations.<sup>181</sup> Each series may have an independent business purpose or investment objective.<sup>182</sup>

To create a series, a partnership agreement must designate whether the series is to involve general partners, limited partners or partnership interests. The agreement must also specify what assets or obligations of the partnership or profits or losses associated with partnership assets or obligations are to be allocated to each series. The agreement should thereafter link the “partners or partnership interests” with the “assets or obligations.”

Next, § 17-218(b) requires that “separate and distinct” records be maintained as to all assets allocated to a series. The assets being held in the “separate and distinct” records may be accounted for directly, indirectly or through a nominee.<sup>183</sup>

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<sup>178</sup> Id. at § 18-213(b).

<sup>179</sup> 6 Del.C. § 17-218.

<sup>180</sup> Id. at § 17-218(a).

<sup>181</sup> Id.

<sup>182</sup> Id.

<sup>183</sup> Id. at (b).

In essence, records may be maintained in any manner that reasonably identifies and distinguishes assets of one series from another.

In addition to the “records” requirement, formation of a series mandates “notice” in a certificate of limited partnership of the “limitation on liabilities of a series” as that series is referenced in the limited partnership agreement.<sup>184</sup> As with the DLLCA, notice of a series in a certificate of limited partnership is sufficient whether or not the series has, in fact, been created in the partnership agreement - the so-called “shelf” series.<sup>185</sup> If more than one series is created in the partnership agreement, explicit reference to each series is not required to satisfy the notice demand.<sup>186</sup> The fact that a certificate of limited partnership that contains notice of a series limitation or a general partner series limitation is on file with the Secretary of State constitutes notice of the respective limitations.<sup>187</sup>

## 2. MANAGEMENT OF A SERIES

In forming a series limited partnership, voting rights of general or limited partners are provided for in the partnership agreement. The voting rights will likely include whether the voting is to be on a financial, per capita, class, group or other basis.<sup>188</sup> A partnership agreement is any agreement of the partners concerning the business affairs of the limited partnership and may be either in written or oral form.<sup>189</sup>

In drafting a series limited partnership agreement, a limited partner may be granted any power or right with respect to a series without being deemed to be participating in the control of the limited partnership or the series.<sup>190</sup> In this manner, a limited partner may be designated the authority to manage a series without jeopardizing its traditional limitation of liability. Management of a limited

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<sup>184</sup> 6 Del.C. § 17-218(c).

<sup>185</sup> Id.

<sup>186</sup> Id.

<sup>187</sup> Id.

<sup>188</sup> 6 Del.C. § 17-218(d), (e).

<sup>189</sup> 6 Del.C. § 17-101(12).

<sup>190</sup> 6 Del.C. § 17-218(d).

partnership series may also be set forth in classes or groups of general partners (or limited partners) associated with a specified series.<sup>191</sup> The powers, rights and duties of the groups or classes are as agreed to in the partnership agreement, including whether the future creation of classes or groups of general or limited partners associated with new series is permitted and if so, the matter and manner of their creation.<sup>192</sup> Where more than one general partner series is created, the liability of each general partner is limited to the series designated to each general partner by the limited partnership agreement. This creation of series of general partners in a limited partnership is an exception to the traditional rule of joint and several liability of general partners in a limited partnership since, in the circumstance of the “series” limited partnership, each general partners’ liability is, by statute, allocated to specific assets where the allocation, separation and notification rules are satisfied.

### **EXAMPLE**

A Delaware limited partnership is created with two general partners and one limited partner. The limited partnership agreement expressly states that the partnership is to be a “series” limited partnership as follows: Series A - Property X of the LP to be allocated to Series A, General Partner A to have all rights and duties of management of Series A; all profits and losses associated with property X to inure to General Partner A; Series B - Property Y of the LP to be allocated to Series B, General Partner B to have all rights and duties of management of Series B; all profits and losses associated with property Y to inure to General Partner B; Series C - Property Z of the LP to be allocated to Limited Partner C; Limited Partner C to have all rights and duties to manage property Z; all profits and losses associated with property Z to inure to Limited Partner C.

Assume a creditor gets a judgment resulting from damages occurring from property Y. Creditor sues the limited partnership and the General Partners A and B. As a result of the series, only property Y and general partner B are subject to liability. Unlike traditional partnership law, the limited partner is not liable, despite participating in control of a series, and the joint and several liability of the general partners is limited by the internal shield of the series.

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<sup>191</sup> Id.

<sup>192</sup> Id.

### 3. WITHDRAWAL OF A LIMITED PARTNER

A limited partner associated with a series is treated in the same manner as a limited partner in a limited partnership without a series.<sup>193</sup> As such, a limited partner in a series may withdraw only upon the happening of events explicitly set forth in the partnership agreement or as otherwise provided for in the agreement.<sup>194</sup> In addition, unless the partnership agreement states otherwise, a limited partner may not withdraw from the partnership prior to the dissolution and winding up of the limited partnership.<sup>195</sup> A partnership agreement may also impose a restraint upon the assignment of a limited partner's interest prior to dissolution and winding up.<sup>196</sup>

In the event a provision in the partnership agreement causes a limited partner to cease to be associated with a series, the limited partner does not (except as otherwise provided in the partnership agreement) cease to be associated with any other series, cease to be a limited partner in the limited partnership or terminate the series.<sup>197</sup>

If a specified event occurs as stated in a partnership agreement, a limited partner ceases to be a limited partner with respect to a series.<sup>198</sup> Except as provided in a limited partnership agreement, a limited partner also ceases to be associated with a series if all of the limited partner's interest in the series is assigned to another.<sup>199</sup> Upon withdrawal, the limited partner is entitled to any distribution provided for in the partnership agreement. If the partnership agreement is silent, the limited partner is entitled to receive the "fair value" of the limited partner's interest in the partnership as of the date of withdrawal.<sup>200</sup> Fair value is to be determined

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<sup>193</sup> 6 Del.C. § 17-218(f).

<sup>194</sup> 6 Del.C. § 603.

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> 6 Del.C. § 17-218(f).

<sup>198</sup> 6 Del.C. § 17-218(f)(1).

<sup>199</sup> 6 Del.C. § 17-218(f)(2).

<sup>200</sup> 6 Del.C. § 17-604. *See Hillman v. Hillman*, 910 A.2d 262, 2006 Del.Ch. LEXIS 217 (Aug. 23, 2006)(§ 17-604 intended to include the withdrawal of limited partners under §17-

based upon the limited partner's right to share in distributions from the limited partnership.<sup>201</sup> Payment to the limited partner should be made within a "reasonable time" after withdrawal.<sup>202</sup>

#### 4. WITHDRAWAL OF A GENERAL PARTNER

A general partner may withdraw from a series upon the happening of an event or at a stated time as provided in a partnership agreement.<sup>203</sup> A partnership agreement may, however, ban withdrawal by a general partner associated with a series as well as the assignment of the general partner's interest with respect to a series.<sup>204</sup> Notwithstanding a ban on withdrawal by a general partner, a general partner may nonetheless withdraw from a limited partnership series at any time by providing written notice to the other partners.<sup>205</sup>

A general partner who withdraws in breach of the partnership agreement may owe damages to the limited partnership and those damages may be offset against any amounts distributable to the general partner.<sup>206</sup> Otherwise, a general partner is entitled to any distribution agreed upon in the partnership agreement.<sup>207</sup> Where a limited partnership agreement is silent on the issue of payment at withdrawal, a general partner is entitled to receive the fair value of her interest in the partnership as of the date of withdrawal, to be paid within a "reasonable time."<sup>208</sup>

If a general partner withdraws with respect to a series, the general partner

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603).

<sup>201</sup> Id.

<sup>202</sup> Id.

<sup>203</sup> 6 Del.C. § 17-218(g); 6 Del.C. §17-602.

<sup>204</sup> 6 Del.C. § 17-602.

<sup>205</sup> 6 Del.C. § 17-602.

<sup>206</sup> 6 Del.C. § 17-602(a).

<sup>207</sup> 6 Del.C. § 17-604.

<sup>208</sup> 6 Del.C. § 17-604.

gives up the power to manage or to exercise any authority, power or right over the series.<sup>209</sup> A withdrawing general partner who has assigned all of her interest in a series or who ceased to be a general partner at a specified time or upon the happening of an event does not cease to be associated with any other series or to be a general partner of the limited partnership.<sup>210</sup>

## 5. DISTRIBUTIONS WITH RESPECT TO A SERIES

Distributions with respect to a series are made in accordance with the terms agreed upon in the limited partnership agreement.<sup>211</sup> However, no distribution may be made regarding a series if, after giving effect to the distribution in general, the liabilities of the series exceed the fair value of the assets associated with the series.<sup>212</sup> The term “distribution” does not include reasonable compensation for present or past services or reasonable payments made in the ordinary course of the series’ business if in accordance with a bona fide retirement or other benefits plan.<sup>213</sup> If a limited partner accepts a distribution wrongfully, knowing at the time that the distribution is wrongful, the limited partner is liable to the series for the amount of the distribution.<sup>214</sup> No liability results for the receipt of a distribution without knowledge of a violation of the statute.<sup>215</sup> The rule of non-liability may be modified by agreement or affected by other law.

## 6. TERMINATION OF A SERIES

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<sup>209</sup> 6 Del.C. § 17-218(g).

<sup>210</sup> 6 Del.C. § 17-218(g)(1), (2).

<sup>211</sup> Id. at § 17-218(i).

<sup>212</sup> Id. Fair value of property of the series that is subject to a liability for which the recourse of creditors is limited is included in the assets only to the extent that the fair value of that property exceeds that liability.

<sup>213</sup> Id.

<sup>214</sup> Id.

<sup>215</sup> Id.

A series may be terminated and its affairs wound up without causing the dissolution of the limited partnership.<sup>216</sup> If a series is terminated, its limitation upon liabilities is not affected.<sup>217</sup> A series is terminated and its business must thereafter be wound upon the dissolution of the limited partnership or upon the first to occur of the following: 1) a time specified in the partnership agreement;<sup>218</sup> 2) the happening of a specified event;<sup>219</sup> 3) unless otherwise provided in the agreement, the affirmative vote or written consent of (i) all general partners associated with the series and (ii) the limited partners associated with the series who own more than two-thirds of the current percentage or other interest in the profits of the limited partnership associated with the series.<sup>220</sup> Certain events of withdrawal may cause termination. Termination may also be sought by application to the Court of Chancery by or for a partner associated with a series where it is not reasonably practicable to carry on the business of the series as set forth in the limited partnership agreement.<sup>221</sup>

## 7. EVENTS OF WITHDRAWAL FROM A SERIES

The withdrawal of a general partner associated with a series does not terminate the series or cause it to be wound up if there is at least one other general partner and the limited partnership agreement permits the business of the series to be continued by the remaining general partner and that partner does so, if (1) within 90 days or any period agreed to by the partners after the withdrawal either (A) if specified in the partnership agreement, the remaining partners agree by vote or in writing to continue the business and to appoint one or more additional general partners for the series if desired, or (B) if no right to continue the business or to appoint additional general partners is provided for in the partnership agreement, then more than 50% of the remaining partners associated with the series agree by

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<sup>216</sup> 6 Del.C. § 17-218(j).

<sup>217</sup> Id.

<sup>218</sup> Id. at § 17-218(j)(1).

<sup>219</sup> Id. at § 17-218(j)(2).

<sup>220</sup> Id. at § 17-218(j)(3).

<sup>221</sup> 6 Del.C. § 17-218(l).

vote or in writing to continue the business of the series and to appoint one or more additional general partners, or (iii) continue the business and appoint one or more additional general partners according to a provision in the partnership agreement.<sup>222</sup>

## **8. LIMITED LIABILITY LIMITED PARTNERSHIP**

A Delaware limited partnership may be formed as a limited liability limited partnership (LLLP).<sup>223</sup> To become an LLLP, a statement of qualification must be filed and thereafter an annual statement.<sup>224</sup> As with the limitation on liability of general partners in an LLP pursuant to the DRUPA, the general partners in a limited partnership also enjoy a limitation upon personal liability. Thus, in the limited partnership context, a series may be formed in an LP or an LLLP in Delaware.

## **9. INDEMNIFICATION**

A limited partnership agreement has broad authority to indemnify any partner or other person from and against any and all claims of any kind.<sup>225</sup> The broad enabling language of § 17-108 is in contrast to the statutory indemnification provision applicable to Delaware corporations.<sup>226</sup> The interpretation of contractual language containing indemnification provisions should be made so as to achieve the beneficial purposes of indemnification where possible.<sup>227</sup> If an agreement is silent on indemnification, a limited partnership agreement should be interpreted to intend

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<sup>222</sup> 6 Del.C. § 17-218(j)(4).

<sup>223</sup> 6 Del.C. § 17-214(a).

<sup>224</sup> The statement of qualification is found at § 15-1001 and the annual report provision in § 15-1003.

<sup>225</sup> 6 Del.C. § 17-108.

<sup>226</sup> See 8 Del.C. § 145 (indemnification for certain persons ... “against expenses...and amounts paid in settlement actually and reasonably incurred by the person...if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporations....”).

<sup>227</sup> *Delphi Easter Partners Ltd. Partnership v. Spectacular Partners, Inc.*, 1993 Del.Ch. LEXIS 159 (Del.Ch. Aug. 6, 1993).

that protection for a partner or other person.<sup>228</sup> The interpretation that a silent limited partnership agreement may intend to indemnify partners or other persons may also be read to intend advances on claims.<sup>229</sup>

## **10. PARTNERSHIP INTEREST; ASSIGNMENT OF A PARTNERSHIP INTEREST**

A partnership interest grants no interest in specific partnership property and instead is an economic interest only.<sup>230</sup> A partnership interest is personal property.<sup>231</sup>

Unless the parties otherwise provide in a limited partnership agreement, a partnership interest is freely transferable in whole or in part.<sup>232</sup> A restriction on transfer is enforceable in Delaware and will not be defeated by commercial restraints imposed by the UCC.<sup>233</sup> The assignment of a partnership interest does not, of itself, dissolve the limited partnership nor does it entitle the assignee to become a partner.<sup>234</sup> Rather, the assignee of the partnership interest has only the right to receive the share in profits, losses, distributions, and allocations of income, gain, loss, deduction or credit that the assignor was entitled to receive.<sup>235</sup> A partner who assigns a partnership interest, except as a pledge or grant of a security interest or other such encumbrance, ceases to be a partner or to exercise any rights of a

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<sup>228</sup> *Active Asset Recovery, Inc. v. Real Estate Asset Recovery Servs.*, 1999 Del.Ch. LEXIS 179 (Del.Ch. Sept. 10, 1999).

<sup>229</sup> *Id.*

<sup>230</sup> 6 Del.C. § 17-701.

<sup>231</sup> *Id.*

<sup>232</sup> 6 Del.C. § 17-702(a)(1).

<sup>233</sup> Delaware has adopted in its alternative entity acts and its versions of UCC Articles 9-406 and 9-408, provisions that make clear that §§ 9-406 and 9-406 of the UCC do not apply to any interest in a general or limited partnership or a limited liability company. *See* 6 Del.C. § 17-1101 (g).

<sup>234</sup> *Id.* at § 17-702(a)(2).

<sup>235</sup> *Id.* at § 17-702(a)(3).

partner.<sup>236</sup> This rule is unlike that in general partnership law where an assigning partner does not automatically cease to be a partner.<sup>237</sup>

An assignee may become a limited partner if the partnership agreement contains a provision so permitting or by the unanimous consent of the partners.<sup>238</sup> An assignee is bound by the terms of the partnership agreement even if the assignee is not admitted as a partner and even if the assignee does not sign the partnership agreement.<sup>239</sup> An assignee that becomes a limited partner assumes the restrictions and liabilities set forth in the limited partnership agreement.<sup>240</sup> The incoming limited partner is liable to make contributions that the assignor was obligated to make unless those obligations were unknown to the assignee at the time the assignee became a limited partner.<sup>241</sup> Admittance of a new limited partner does not release the assignor from liability to the partnership for contribution and distributions.<sup>242</sup>

A judgment creditor of a partner or a partner's assignee may petition the Court of Chancery for a charging order to satisfy the judgment.<sup>243</sup> To the extent of the interest charged, the creditor is only entitled to receive "any distribution or distributions to which the judgment debtor would otherwise have been entitled."<sup>244</sup> A charging order is the exclusive remedy for a judgment creditor of a partner or a partner's assignee and this remedy does not include obtaining possession of

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<sup>236</sup> Id. at § 17-702(a)(4).

<sup>237</sup> See 6 Del.C. § 15-503(b)(d) ("Upon transfer, the transferor retains the rights and duties of a partner other than the economic interest transferred.") (but may be expelled by other non-transferring partners, § 15-601(4)(ii)).

<sup>238</sup> 6 Del.C. § 17-704.

<sup>239</sup> Id. at § 17-101(12).

<sup>240</sup> Id. at § 17-704(b).

<sup>241</sup> Id.

<sup>242</sup> Id. at § 17-704(c).

<sup>243</sup> 6 Del.C. § 17-703.

<sup>244</sup> Id. at § 17-703(a).

property of the limited partnership.<sup>245</sup>

## **11. MODIFICATION OF DUTIES IN A LIMITED PARTNERSHIP AGREEMENT**

As with the other Delaware alternative entity acts, the DRULPA adopts a policy of enforceability of partnership agreements and the principle of freedom of contract.<sup>246</sup> In drafting limited partnership agreements, parties are free to expand, restrict or eliminate duties, including fiduciary duties, that a partner or other person has to the limited partnership, other partner or other person that is a party to the partnership agreement.<sup>247</sup> The partnership agreement may not eliminate the contractual duty of good faith and fair dealing.<sup>248</sup>

Instead of eliminating fiduciary or other duties, a partnership agreement may provide that a partner or other person that is a party to the agreement has no liability for a breach of fiduciary duty for the partner's or other person's good faith reliance on provisions of the partnership agreement.<sup>249</sup> In yet another alternative, a limited partnership agreement may provide for the elimination or limitation of liability for breach of contract and breach of duty for any partner or other person that is a party to the partnership agreement.<sup>250</sup> Any limitation or elimination of liability for breach of contract cannot provide for exculpation involving an act or omission that constitutes a *bad faith* breach of the contractual duty of good faith and fair dealing.<sup>251</sup>

The choice in Delaware alternative entity law is unlike that in the Delaware General Corporate Law (DGCL). In the Delaware alternative entity law, fiduciary *duties* may be eliminated as well as liability for breach of duties and breach of

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<sup>245</sup> Id. at § 17-703(d), (e)(the remedy of foreclosure is not permitted)..

<sup>246</sup> 6 Del.C. § 17-1101(c).

<sup>247</sup> Id. at § 17-1101(d).

<sup>248</sup> Id.

<sup>249</sup> Id. at § 17-1101(e).

<sup>250</sup> Id. at § 17-1101(f).

<sup>251</sup> Id.

contract. In the DGCL § 102(b)(7),<sup>252</sup> only liability for breach of the fiduciary duty of care may be eliminated with the result that secondary advisors such as officers, attorneys, accountants, and investment bankers remain at risk for claims of aiding and abetting or conspiracy to breach of a fiduciary duty. In the unincorporated entity law of Delaware, secondary advisors are protected by the elimination of duties and liabilities for breach of duties and contract.

## **12. FOREIGN LIMITED PARTNERSHIP REGISTERING TO DO BUSINESS**

If a foreign limited partnership that is registering to do business in Delaware is formed and governed by a limited partnership agreement that establishes one or more series of limited partners, general partners or limited partnership interests that have independent rights, duties or powers as to designated foreign limited partnership property or obligations or profits or losses associated with specified foreign limited partnership property the fact of the series must be stated on the application for registration as a foreign limited partnership.<sup>253</sup> Furthermore, the application must disclose whether the debts, obligations and liabilities incurred, contracted for or otherwise existing with regards to a particular series or general partner associated with a series is enforceable against only the assets of that series and not against the assets of the foreign limited partnership in general or any other series in specific.<sup>254</sup>

As discussed above, the real issue is whether a Delaware court would recognize a foreign series entity that failed to register to do business in Delaware where that entity is a defendant in a Delaware action. As a matter of comity, it seems likely that a Delaware court would apply the law of the foreign entity, including any series provisions. The inverted question is whether a non-Delaware court in a jurisdiction that has no enabling series legislation would recognize the Delaware series. In the only action of record thus far, the answer appears to be yes.

## **13. DUAL STATUS; DOMESTICATION OF OR TRANSFER BY NON-UNITED STATES ENTITIES**

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<sup>252</sup> 8 Del.C. § 102(b)(7).

<sup>253</sup> 6 Del.C. § 17-218(m).

<sup>254</sup> Id.

Any non-United States entity may domesticate as a Delaware limited partnership and continue its existence in its foreign jurisdiction.<sup>255</sup> A domesticating foreign entity and the continuing entity in the foreign jurisdiction constitute a single entity governed by the laws of Delaware and the laws governing the foreign entity.<sup>256</sup> Approval of the domestication is as set forth in the document, agreement or other writing governing the internal affairs and the conduct of the business of the non-US entity or by non-Delaware law, where applicable.<sup>257</sup>

By the same token, a Delaware limited partnership may transfer to a non-US jurisdiction and elect to continue its existence in Delaware thus creating a “dual status” entity. The transferring entity to a non-US jurisdiction and the continuing Delaware limited partnership is the same entity and is governed by the laws of Delaware and the laws of the jurisdiction of the transferring entity.<sup>258</sup> A transfer or transfer and continuance is approved: (1) as set forth in the limited partnership agreement; (2) if the partnership agreement is silent, as is specified for approval of mergers if transfers or transfers and continuances are not prohibited by the agreement; (3) if the agreement is silent on mergers and does not prohibit transfers or transfers and continuances, then by the approval of all general partners and a majority in the then current percentage interest in profits of the limited partners.<sup>259</sup>

#### **D. THE DELAWARE REVISED UNIFORM PARTNERSHIP ACT**

The DRUPA does not contain a series provision. First, such a provision does not make sense in a general partnership where partners are jointly and severally liable for partnership obligations.

As for a limited liability partnership, § 15-407 of DRUPA permits a partnership agreement to provide for classes and groups of partners having rights, powers and duties as agreed to by the partners to the agreement.<sup>260</sup> The agreement

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<sup>255</sup> 6 Del.C. §17-215.

<sup>256</sup> 6 Del.C. § 17-215(i).

<sup>257</sup> 6 Del.C. § 17-215(b)(6).

<sup>258</sup> 6 Del.C. § 17-216.

<sup>259</sup> Id. at § 17-216(b).

<sup>260</sup> 6 Del.C. § 15-407(a).

may also permit the creation of future classes and groups as well as the taking of action, including amendment of the partnership agreement, in any manner, method or matter agreed upon by the partners.<sup>261</sup> Meetings of the partners may be held in person, by telephone or other communications equipment so long as all persons participating in the meeting “can hear each other . . . ”<sup>262</sup> The default rule for voting permits written consent that may be transmitted in electronic form.<sup>263</sup> Unless the partnership agreement contains a provision regarding amendment, amendment of the agreement requires the consent of all the partners.<sup>264</sup> Consent may include the approval of a person who is not a party to the partnership agreement or the satisfaction of a stated condition.<sup>265</sup>

The question under the DRUPA is whether partners can form a limited liability partnership with classes of designated assets and obligations of the partnership, maintain distinct records for each separate class, provide notice of the classes in the registration of the partnership as an LLP, and thereafter receive a limitation on liability as in the DLLCA and the DSTA? Despite what appears to be compliance with the *records, notice, and segregation* of aspects of a series, the limitation on liability is missing *within the statute*.

A policy argument could be made that freedom of contract and enforceability of contractual agreements militates in favor of the recognition of the segregation of partnership assets into classes. Where this argument fails is in the *additional request for a limitation upon liability for each class* - an attribute that is neither recognized by the DRUPA nor one that can be created by contract since it affects the rights of third parties. Thus, the creation of a series under the DRUPA is not available for partners, whether or not the partnership is an LLP.

### III. COMMONLY ASKED QUESTIONS

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<sup>261</sup> 6 Del.C. § 15-407(a), (b),(c).

<sup>262</sup> Id. at (d).

<sup>263</sup> 6 Del.C. § 15-407(d).

<sup>264</sup> Id. at (e).

<sup>265</sup> Id.

## A. HOW DOES A SERIES WORK?

First, in order to create a series in Delaware, there must be an allocation or “separation” of the organization’s property or assets into smaller “cells” or “units.” This allocation of property, assets or obligations of the entity is thereafter to be chronicled in “separate and distinct records.” Thus, the necessary first stage in the creation of a series is characterized by an *allocation* of business property into smaller or “separate” units - *i.e.*, a “separating out” of property, assets or company obligations.

The second stage involves the linking of a member, manager or membership interest with a series for the purpose of receiving profits, losses, and distributions and the determination of management rights and duties. This “linkage” also serves the purpose of determining such matters as the numbers necessary to take action for ordinary and extraordinary events, adding members, managers or series, dissolution, merger or conversion, and exit rights, to name a few. In sum, the second stage involves the central contractual capstone of the series that sets forth all the rights and duties of the persons associated with the series. This stage defines, and delimits, all powers of the members and managers except as are intended to be governed by the statutory default rules of the governing statute. Other provisions of LLC, LP or Statutory Trust Act may be added at this juncture, including modification or elimination of default fiduciary duties, elimination of liability for breach of duties or good faith breach of contract, indemnification, exit strategies, reasonable restrictions on information rights, restrictions on transfer of ownership interests, and dissolution upon specified events.

The critical third stage ensures a limitation on liability of one series as against any other. In order to achieve limited liability, notice of the series must be referenced in a certificate of formation of the entity to be organized. The certificate of formation can be amended to add a series if the original certificate did not contain a series. In Delaware, a series does not have to be in existence to make to required notice for an LLC or LP. A series statutory trust requires an existing series to meet the notification requirement. Good practice suggests that any certificate of formation refer directly to the statutory language on limitation of liability in order to ensure maximum notice of the series and thus complete compliance with the statutory directive of notice of the liability limitation.

If each of these three prongs is met, a statutory Delaware series is created with the practical effect of providing internal liability shields for each separate allocated “unit” of entity property or assets for which separate and distinct records are maintained. If distinct records are not maintained or the required statutory

notice is not satisfied, independent liability shields as among one failed series to the next will not be recognized. In the case of a failed series, a creditor may proceed against property or assets allocated to the failed series assigned to a partner or member according to a charging order as if the failed series had never been created. However, the failure of one series does not affect the validity per se of another.

### EXAMPLE

Assume two out of three siblings, desire to start an investment business for the purpose of generating income for heart research. The two siblings are investing \$500,000.00, \$500,000.00 in stocks and bonds, and \$1,000,000.00 in real estate mortgage income investment devices. The two contributing siblings want all three siblings to be “owners” in the business but want distributions to the youngest sibling to be for “medical, emotional, and related expenses only” at this time. Assuming the siblings wish to form a Delaware LLC, how is the LLC to be organized?

Assume first that the LLC is formed as a simple member-managed LLC with all assets contributed by the two older siblings. Under the DLLCA, distributions of cash, assets, profits and losses may be allocated according to the limited liability company agreement.<sup>266</sup> Thus, the LLC agreement may provide that the youngest sister receives a distribution only for “medical, emotional and related expenses” as determined by the youngest sister, by the older siblings, or by all three together. There is no requirement that the youngest sister make a contribution to the LLC in order to receive a distribution.<sup>267</sup>

Assume, however, that in the first year the older siblings invest aggressively in the stock and options market. Assume also that their plan backfires and the loss is in excess of \$1,500,000.00. In order to cover this loss, a certain liquidation of assets will be necessary. After these losses are covered, the LLC likely is left with less than \$500,000.

What would change if the LLC was organized as a “series” LLC? In the case of a “series” LLC, the different *types of assets* in this example could be placed into individual series. Next, a member or group of members (i.e., the siblings) could be

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<sup>266</sup> 6 Del.C. § 18-503 (Allocation of profits and losses); § 18-504 (Allocation of distributions); § 18-501 (Form of contribution includes cash, property or services rendered....).

<sup>267</sup> 6 Del.C. § 18-501. (Contribution of a member *may* be in cash.....).

associated with each series for the purpose of voting/decision-making and receipt of income from the assets associated with the series. Further, each series could be designated with an independent business purpose, *i.e.* series one could be created for research, series two for funding and series three for sibling number three's medical and other appropriate expenses.

The management of the series could be by all the siblings or any combination thereof. The distributions could be "as determined by the discretion" of designated members or in any other appropriate manner. The distributions could be solely discretionary, capped, or in a specified amount necessary to cover "any medical or psychological expenses incurred." In essence, the variations are limitless as to management, income distributions, purpose associated with the series, termination of the series, replacement of members, information provided, or any other infra-structural issue.

The *benefit of the series* is that any *loss, liability or obligation* associated with the assets of a series stay with the series and does not attach to the assets of the LLC in general or the assets of any other series. Hence, in the example above, the losses incurred by the speculation in the stock and option's market would be limited to the series in which those assets were placed and would not wander to the LLC assets in general or implicate the assets of other series.

## **B. WILL THE SERIES BE TREATED AS AN INDEPENDENT "PERSON" FOR PURPOSES OF FEDERAL BANKRUPTCY LAW?**

In bankruptcy, a petition may be filed by any "person."<sup>268</sup> The term "person" is defined to include an individual, partnership, or corporation,<sup>269</sup> but not an estate or trust (other than a business trust). The definition of "corporation" includes "a partnership association organized under a law that makes only the capital subscribed responsible for the debts of the association,"<sup>270</sup> includes unincorporated company or association,<sup>271</sup> and a business trust<sup>272</sup> and excludes limited partnerships.

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<sup>268</sup> 11 U.S.C. § 109(a).

<sup>269</sup> 11 U.S.C. § 101(41).

<sup>270</sup> 11 U.S.C. § 101(9)(A)(ii).

<sup>271</sup> 11 U.S.C. § 101(9)(A)(iv).

<sup>272</sup> 11 U.S.C. § 101(9)(A)(v).

As to partnerships, the defining characteristic for inclusion is the vicarious liability of the partners and their obligation to contribute for partnership debts - a trait not present in limited liability entities.

So, where does that leave the Delaware series? First, the amendments to §18-215 provide that the term “person” includes any *entity(or series thereof)*. The amendment appears to provide that the series is a legal “person.” The intended purpose of the amendment was to make clear that a “person” conducts such activities as contracting, granting liens and holding property. The amendments did not go so far as to imbue the series with legal personhood independent of its organizing entity status. Stated another way, once a series is formed and holds property and is vested with an individual manager/s, some “person” or “agent” must be able to act for the series. The 2006 amendments clarify that the series is a “person” for certain business reasons. It does not answer the question of “personage” for federal bankruptcy purposes.

As to the series being a partnership under bankruptcy law, neither its members nor managers have vicarious liability and thus fail the characteristics necessary for partnerships under bankruptcy law. By the same token, the series shares only limited liability with a corporation - no other common features attain with the corporation.

At this juncture, then, it would appear that a Delaware series cannot file a petition in bankruptcy without statutory authority.

### **C. WILL A DELAWARE SERIES BE ENFORCED IN A NON-SERIES JURISDICTION?**

Basic principles of comity would suggest that a foreign court would recognize the Delaware series and apply Delaware law to interpret the legal effect of a series upon members, managers or claimants to assets shielded by the internal series limitations on liability. In the one Delaware series case decided by a non-Delaware court (Maine), *G x G Management LLC v. Young Brothers and Co., Inc.*,<sup>273</sup> the court was not put off by the existence of the series. Rather, the court looked to the Delaware act to determine what capacity an LLC has to pursue litigation on behalf of a series or, in the alternative, what capacity a series has to pursue litigation on its own behalf or whether the series could be regarded as an entity distinct from the LLC. In that case, the court found that the LLC had an interest sufficient in the series so as to permit the LLC to maintain an action as a real party in interest. In a subsequent ruling, the court made clear that it had not decided that the series was a separate entity and that even if the series could otherwise maintain an action in its own name, it could not in this case because the action would arise out of the same facts being litigated by the LLC.

In contrast to the Maine approach is that in California where the foreign law recognition of a mere LLC is quite narrow. For example, in the case of *Butler v. Adoption Media, LLC*,<sup>274</sup> a California court interpreted a reference to “internal affairs and the liability and authority of its managers and members” to simply mean a codification of the internal affairs doctrine and not to include disputes arising as a result of negotiations by the LLC or its agents with third parties.

### **D. WHO OWNS THE ASSETS OF THE SERIES, I.E., IS THE SERIES AN ENTITY?**

Recall that a member of an LLC does not “own” *property* of a limited liability company. Section 701 of the DLLCA provides that: “A member has no interest in specific limited liability company property.”<sup>275</sup> Thus, it is fundamental

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<sup>273</sup> 2007 WL 551761 (D.Me. 2007).

<sup>274</sup> 2005 WL 2077484 (N.D.Cal. 2005).

<sup>275</sup> 6 Del.C. § 18-701.

LLC law that a member's interest in an LLC is "personal property"<sup>276</sup> and is an *income interest* only.<sup>277</sup> It therefore follows that if a member in an LLC cannot own "property" of an LLC, a member of a series also cannot own "property" of a series. A member or manager owns neither more nor less than that which a member or manager could own in an LLC - an "interest" in income only.

"Management" of an LLC is non-transferable unless provided for in an LLC agreement or by consent of all members.<sup>278</sup> The "debts, obligations and liabilities" of a limited liability company, whether arising in tort, contract or otherwise, are *solely those of the LLC* and no member or manager of the limited liability company is personally obligated for those debts or obligations solely by being a member or manager.<sup>279</sup> The LLC, not the members or managers, has the authority to carry on the business, purpose or activity for which the LLC was formed.<sup>280</sup> Thus, the limited liability company, not its members, owns its *property*.

What, if anything, changes with the formation of a *series limited liability company*? Section 18-215(a) provides that an LLC agreement may contain one or more series of "members, managers or limited liability company interests having separate rights, powers, or duties with respect to *specified property or obligations of the limited liability company* or profits and losses associated with *specified property or obligations . . .*"<sup>281</sup> Therefore, interpreting § 18-215(a) in a clear, reasonable manner, the *LLC owns* the assets of the series; the series constitutes an *allocation of company assets* for the purpose of limitations upon liabilities. The creation of series of property or obligations of the LLC or profits and losses associated with LLC property or obligations may be viewed simply as allocations of LLC "property" into "cells" or "units." If "notice" is given and "distinct records" maintained according to subsection (b), the intended purpose of the series is a

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<sup>276</sup> Id.

<sup>277</sup> 6 Del.C. §§ 18-702(a), (b).

<sup>278</sup> Id.

<sup>279</sup> 6 Del.C. § 18-303.

<sup>280</sup> 6 Del.C. § 106. This is not to say that the LLC cannot act through its agents. However, for the purpose of representation in court, neither a member or manager may represent the LLC; Delaware legal counsel is necessary. *Poore v. Fox Hollow Enters.*, 1994 Del.Super. LEXIS 193 (1994).

<sup>281</sup> 6 Del.C. § 18-215(a).

*division of assets and a resulting limitation upon liability to those assets-* not the creation of an independent entity.

The marketplace, however, focuses upon Delaware's 2007 amendments to § 18-215 to suggest that the "series" is now, in fact, an "entity." The factors being debated include that the series may: 1) contract; 2) hold title to assets; 3) grant liens or security interests; and 4) sue or be sued.<sup>282</sup>

First, any "person" may "enter into a contract" unless that person is either a minor<sup>283</sup> or a mentally incapacitated person. In 2006, Delaware amended the term "person" in the DLLCA to include a "limited liability company . . . or any other individual or entity (*or series thereof*). By this addition, Delaware clearly answered that a "series" is a "person" capable of contracting in a statutory sense. Whether an *individual agent* acting on behalf of the series has capacity to contract must be determined under the common law of contracts. The nuance to the amended definitional section is that the term "series" appears in a derivative capacity - i.e., series modifies "or entity." Thus, when this person known as a "series" acts, it *does so thereof*<sup>284</sup> *as a series of a limited liability company or other entity*. Simply put, as its definition establishes, its "personage" is *derivative of* the limited liability company which is formed if in the certificate of formation. The "series" does *not* appear to be an independent "*entity*" as defined in the DLLCA.

If the interpretation of "person" is correct, it follows that the "series" may hold title to assets, grant liens or security interest and sue or be sued in the same derivative manner. In other words, the series is a person for a convenience purpose yet not an independent legal entity.

## **E. FIDUCIARY DUTIES IN A SERIES**

Assume in the Example that three series are formed and that the first two series have one each of the older two siblings associated as members of the series. Assume also that each sibling is assigned a 100% income interest in the appropriate series. Do the members owe each other fiduciary duties from one series to the other?

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<sup>282</sup> See footnote 22.

<sup>283</sup> Of course, minors may enter into voidable contracts - voidable by the minor until the minor's coming of age and the acceptance (or ratification) of the contract.

<sup>284</sup> 6 Del.C. § 101(12). The definition of "thereof" means "of that or it."

First, the limited liability company agreement spells out the rights and duties of the members of the LLC, including the rights and duties of members associated with series. In this case, the first two series are formed with a single member associated with each independent series. Each member receives 100% of the income rights from the series. The question is whether the members owe fiduciary duties to each across series boundaries.

The common law in Delaware is that fiduciary duties attach unless specifically modified in an operating agreement. There is no doubt that under the DLLCA that the members may set forth provisions in the company agreement that limit or eliminate fiduciary duties to each other. So long as the members act according to the agreement, the members are protected in contract for good faith reliance on those provisions and thus liability will not follow. However, there is no exculpation for a bad faith breach of the implied duty of good faith and fair dealing.

The more difficult question is raised if the operating agreement is silent as to fiduciary duties. Because the series are being maintained as distinct cells, with independent assets, obligations, income and losses as well as with independent management, should the default rule not be that fiduciary duties run with each series and not presumptively across borders? In this manner, the parties are better protected in their bargain by the enforcement of the terms of the limited liability company agreement. The answer appears to be “yes” since the series is “segregated” for virtually all purposes: income, management, assets, liabilities and business intent. As such, it is logical to assume that the members may manage the series independently of the other without concern of common law fiduciary duties. However, given the case law in Delaware, the better course of action is to make clear in the operating agreement that the duties and liabilities of each series are expressly limited to each particular series and eliminated in all other instances. This course of action is particularly important where two or more members are associated with one or more series.

Consider a slight variation on this example. Assume that the “business” is not an investment enterprise but instead involves the operation of six liquor stores in Delaware and that only one liquor license may be obtained for “the business.” In this case, it makes sense to hold each property in an independent “cell” for liability and profits purposes and also to maintain all properties under one single entity due to the licencing issue. If a member or members are associated with each store for purposes of management, profits, and day-to-day decision-making, do these members owe fiduciary duties across series boundaries? Here the question is more problematic since the reckless operation of one site could result in the loss of license for all the remaining properties. In that circumstance, one could conclude

that reasonable parties “should” have considered negotiating this subject. On the other hand, the series is a “contract within a contract” with special “records” and “barrier” requirements. A logical default rule for duties is that of the contractual obligation of good faith and fair dealing. Although this currently runs against Delaware case law, the time is near when Delaware courts should recognize that contractual entities that trade on a premium and stated policy of contractual freedom should observe a default rule of contractual duties rather than gap-filling fiduciary duties. In any event, in this hypothetical, the parties are certainly free to craft their fiduciary duties to whatever suits their desires. At this stage in the development of Delaware law, it seems more likely that a court would impose fiduciary duties under a “hypothetical bargain” despite the contractual barriers of the series.

#### **IV. COMMON MISTAKES OCCURRING IN A SERIES**

##### **A. CROSS COLLATERALIZATION**

In order for the limitation on liability to be enforced as among series, separate books and records, however reasonably maintained, must be kept. Yet, no matter how vigorously records are maintained, if new credit is being sought and a lender requires cross-collateralization among the series, a serious question is raised whether a court would honor the liability limitation. In this circumstance, it is recommended that security interests not be granted across series’ borders.

##### **B. CREATION OF A SERIES - WHAT LANGUAGE IS NECESSARY?**

What language is necessary to create a series? Section 18-215(b) simply provides that notice in a certificate of formation of the “limitation on liabilities of a series” is sufficient for all purposes, whether or not the LLC has formed a series at the time the notice is included in the certificate of formation. Is stating that the LLC is a “series” limited liability company “with all the limitations provided by law” sufficient? Probably. Is simply referring to a “series” LLC enough? Probably not since there is not any reference to a limitation upon liability. For practical purposes, a safer route would be to track the language of the statute that creates the series, including the recitation of the limitation on liabilities.<sup>285</sup>

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<sup>285</sup> A certification of formation for a series is provided as an Exhibit compliments of Walter Tuthill, Esq. of Morris, Nichols, Arsht and Tunnell of Wilmington, DE.

### **C. UNALLOCATED PROPERTY IN A GOVERNING DOCUMENT**

In some circumstances, an entity may terminate and be wound up with unallocated property and no mechanism for the subsequent allocation of that property. Since at the time of the formation of the organization it is possible that the nature or circumstance of unallocated property makes it unadvisable to adopt a *preallocation system*, a *method* by which the property may be divided should be set forth in the operating agreement. Thus, advisors using a series arrangement need to anticipate a decision-making mechanism whereby unallocated property may be designated among series or otherwise.

### **D. CONTRACTING BY OR ON BEHALF OF A SERIES**

This topic is quite controversial. Recall that the 2007 amendments permit a “series” to contract in its own “name.” Recall also that a “series” is a “person” whose identity is *derivative of the limited liability company as per the 2006 amendments*. Therefore, although it is technically possible for a series to contract in its own “name,” its status is derivative of the organization. Stated another way, the series is not an “entity” independent of the organized entity. In practice, therefore, a safe course is to have a series sign *in the capacity of or thereof as a series of the organization formed*. By statute, however, it may sign in its own capacity.

## **SUMMARY**

The Delaware “series” is an innovative and efficient method by which attorneys and advisors may plan for “classes,” “groups” or “series” of interests and by providing notice of the groups, classes or series, limit liability to the interests and assets attached to same. If the parties who use “series” or other such classifications are informed as to the purposes and “rules” regarding their use, series provide good business planning for the informed.