

**THIRD-PARTY DELAWARE OPINIONS
FOR STRUCTURED FINANCE AND OTHER COMMERCIAL TRANSACTIONS**

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Part I of III:
Introduction to Delaware Entities and Opinions Practice

INTRODUCTION

With the continued use of structured finance transactions and the use of Delaware limited liability companies and Delaware Statutory Trusts in those transactions, opinion letters on Delaware law are today often required by real estate lenders and loan rating agencies.²

Limited liability companies and certain business trusts are widely recognized as entities of choice to provide direct interests in real estate with flexibility in organization, limited liability and favorable tax treatment. These entities facilitate the exchange of like-kind property under IRC § 1031.³ They are widely used in structured finance and other secured finance transactions.

Delaware law opinion letters provide both lenders and rating agencies comfort, on top of bankruptcy-remote requirements placed on a borrowing entity, that the entity was validly formed, that it duly authorized the transaction, and that the entity and the mortgaged property generating the cash flow to investors have been separated from other entities, assets, properties, and liabilities.⁴

WHY DELAWARE?

¹ The authors are partners at the law firm of Berger Harris in Wilmington, Delaware. These materials have been prepared by Berger Harris for information purposes only and are not legal advice. The information contained herein is not intended to create a lawyer-client relationship.

² For a discussion of the contents of all opinions, *see generally* Committee on Legal Opinions and the TriBar Opinion Committee, *THE COLLECTED ABA AND TRI-BAR REPORTS* (American Bar Association 2009).

³ See Treas. Regs. §301.7701-(3) (b) (1) (single member limited liability companies); IRS Ltr. 199911033 (multiple-member limited liability companies); and Rev. Rul. 2004-86, 2004-33 I.E.B. 191 (8/16/2004) (Delaware Statutory Trusts).

⁴ While lenders and loan rating agencies have been willing to accept opinions from non-Delaware attorneys concerning Delaware corporate law because historically almost all commercial lawyers have had some training in Delaware corporate law, opinions from members of the Delaware Bar have been required on LLCs and DSTs acting as borrower/fee owners, tenants, management companies, etc.

Delaware nurtures business entities.

Delaware, the "Corporate Capital", has been the forum of choice for formation of business entities for over 100 years. While limited liability companies and business trusts are found in many other jurisdictions, Delaware LLCs ("LLCs") and Delaware Statutory Trusts ("DSTs") have become the vehicle of choice in many real estate ventures. The number of Delaware LLCs has grown to exceed the number of corporations in Delaware. The Delaware limited liability statute was enacted in the mid-1980s and while it was a popular vehicle for Delaware businesses, following 1996, when Delaware amended the statute to better reflect the needs of the business/financial community, the use of Delaware LLCs by investors around the country skyrocketed. According to the Delaware Secretary of State's Division of Corporations, as of March 29, 2013 there were 1,001,200 business entities domiciled in Delaware (up from 675,000 in September 2006). Of these, 257,598 were domestic corporations, 76,641 were domestic limited partnerships, and 23,094 were statutory trusts. 643,867 were limited liability companies, representing a more than 100% increase since early 2006. Delaware has adapted and expanded the concept of "flexibility" from its corporate and contract laws to its laws creating and enabling these entities.

Business trusts were commonly used during much of the 19th and 20th centuries to hold real property in areas where corporations were prohibited.⁵ However, the traditional form of business trust was too restrictive for great usefulness in the modern business environment. The Delaware Statutory Trust Act combines the traditional form of business trust with the flexibility of organization and management that Delaware traditionally (and increasingly) grants to business entities. It is used together with a "Springing LLC" to provide the continuity of existence in the event of default.

Easy Administrative Procedures.

The Division of Corporations of Delaware's Department of State is renowned for its state-of-the-art capabilities which facilitate a broad range of filing and business activities for all Delaware business entities.⁶ The website provides online services that include:

- Filing of UCC documents.
- Payment of franchise taxes.
- Access to relevant provisions of the Delaware Code.⁷
- Help with finding a registered agent.⁸

⁵ For a full history of statutory trusts and similar entities, see Charles J. Durante and Brian M. Gottesman, *et al.*, DELAWARE STATUTORY TRUSTS MANUAL (Matthew Bender, 2010).

⁶ <http://www.state.de.us/corp/default.shtml>.

⁷ <http://www.state.de.us/corp/DElaw.shtml>.

⁸ <http://www.state.de.us/corp/remotegts.shtml>.

- An entity search engine.
- Name reservation for new entities.
- Expedited, same day service.⁹
- Status check for Delaware entities.¹⁰
- Some Delaware registered agents have direct connections to the Division of Corporation's electronic database and can file entity formation documents electronically.

Expertise of judiciary in business matters.

Delaware judiciary and legal system is consistently voted the best in the United States by the Harris Poll conducted for the Institute for Legal Reform of the U.S. Chamber of Commerce annual poll of corporate attorneys and general counsel.¹¹

Delaware's Court of Chancery is a court of limited jurisdiction with particular expertise in resolving corporate and entity disputes. It is widely recognized as the preeminent court in the nation for business-related disputes.

The state-of-the-art facilities at the Division of Corporations, the flexibility of the law and the expertise of the judiciary have not occurred by happenstance. The volume of corporations and now limited liability companies and the sophistication of litigation engendered by these entities have required the Delaware Bar to be on the cutting edge of business planning. As the needs and realities of businesses have changed over the years, the Corporations Section of the Delaware State Bar Association has routinely monitored case law and business trends and generated legislation to allow the Delaware entities to accommodate those needs. As a small state, Delaware provides easy access to elected and appointed officials who recognize the need for the State to remain at the cutting edge of business organization law. With the assistance of the Bar, the Executive and Legislative branches of state government continually fine-tune the laws and regulations impacting business organizations.

Delaware defers to contract.

Delaware's LLC and DST statutory scheme offers flexibility to investors by, *inter alia*, permitting a single member LLC or an LLC with a series of members, etc. Yet it also enables the restrictions which lenders and underwriters demand by facilitating the creation of a single purpose entity ("SPE"), *i.e.*, an entity which is separate from its affiliates, owns only the subject property and has no other debt.

Delaware courts rely heavily on the concept of freedom of contract.¹² Accordingly, most

⁹ <http://www.state.de.us/corp/expserv.shtml>.

¹⁰ <http://www.state.de.us/corp/onlinestatus.shtml>.

¹¹ <http://www.instituteforlegalreform.com/harris/>

¹² *Cantor Fitzgerald, L.P. v Cantor*, 2000 Del. Ch. Lexis 43, (Del. Ch. March 13, 2000),

provisions of the LLC Act, 6 *Del. C.* § 18-101 *et seq.*, contain the following proviso: "Except as provided in a limited liability company agreement" or other similar language.¹³

The Delaware Statutory Trust Act, 12 *Del. C.* § 3801 *et seq.*, also provides great flexibility and deference to the governing instrument. *E.g.*, § 3817 [indemnification]; § 3819 [access to records]; § 3803 [limitation of liability]; § 3802(b) [contributions by beneficial owners]. Of special import is § 3805, which allows almost limitless flexibility in the establishment of the rights and powers of beneficial owners.

Case law demonstrates great deference to contract and to decisions of company management.

The business judgment rule has long been recognized in the corporate context. In essence, there is a rebuttable presumption by the court that directors acted in good faith and with due care.¹⁴ Furthermore, the court does not impose itself unreasonably on business affairs of corporation.¹⁵

Delaware courts give great deference to the decisions of corporate managers.¹⁶

Favorable state tax treatment.

Federal "pass-through entities" are "pass-through entities" for Delaware income tax purposes.¹⁷ Delaware follows the federal "check the box" election for taxing the income of an LLC.¹⁸ Non-pass-through entities pay Delaware's state income tax only on income sources in the state of Delaware.¹⁹ Delaware's franchise taxes are limited, *e.g.* \$250.00

appeal dismissed, 755 A.2d 387 (Del. 2000).

¹³ *E.g.*, 6 *Del. C.* § 18-107; § 18-108; § 18-213(b); § 18-304 [bankruptcy]; § 18-402 [management]; § 18-404 [classes and voting]; § 18-803 [winding up]. While this outline is generally confined to LLCs and DSTs, the Delaware Revised Uniform Partnership Act, 6 *Del. C.* §§ 15-101 *et seq.* and the Delaware Revised Uniform Limited Partnership Act, 6 *Del. C.* §§17-101 *et seq.*, follow a similar statutory scheme to the LLC Act and many similar, if not identical, provisions are applicable to those entities.

¹⁴ *E.g.*, *McMullin v. Beran*, 765 A.2d 910 (Del. 2000); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

¹⁵ *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993).

¹⁶ *In re Walt Disney Co. Deriv. Litig.*, 2005 WL 2056651, at *14-15 (Del. Ch. Aug 9, 2005); *In re Compucom Systems, Inc. Stockholders Litig.*, 2005 WL 2481325 (Del. Ch. Sep. 29, 2005).

¹⁷ 30 *Del. C.* § 1605 (a).

¹⁸ 30 *Del. C.* §§ 1621 *et seq.*

¹⁹ 30 *Del. C.* §§ 1121 *et seq.* (individual); 30 *Del. C.* § 1902 (corporate).

annually per LLC.²⁰

THE DELAWARE OPINION LETTER

The Delaware LLC and DST opinions require careful review of documents and knowledge of the specific entity acts and case law. Like all legal opinions, they are time sensitive.

Documents required to give a Delaware opinion.

To avoid last minute holdups, copies of all documents (as well as any changes to drafts of documents) should be provided to counsel as soon as possible. Executed "Entity Documents" (generally in PDF or facsimile copy) are required to give an opinion of validity and good standing or authority to file voluntary bankruptcy (see below). These documents include:

- A Certificate of Good Standing from the Delaware Secretary of State for each entity.
- A certified copy of the Certificate of Formation or Certificate of Trust from the Delaware Secretary of State for each entity.
- A fully executed limited liability company agreement (sometimes called an operating agreement) or trust governing instrument for each entity.

It is NECESSARY to provide Delaware counsel with drafts before the documents are finalized. This helps avoid "carve outs" in the opinion or amendments of documents should the limited liability company agreement (or Certificate of Formation) include language which would not be valid or enforceable under Delaware law.

Copies of all "Loan Documents" are required for most other opinions which are generally requested by the lender and the rating agency, even if the Delaware counsel is not opining on the enforceability of such Loan Documents (because, for example, they are governed by the law of a different state). To expedite the opinion, unexecuted drafts are frequently reviewed, subject to receipt of executed final drafts at the time of closing. A potential delay exists in release of the opinion when lender's counsel requests reference to documents "executed by" the parties in the opinion when those documents will not be executed until the date of closing.

There is no set list of documents that must be reviewed by Delaware counsel; the number and nature of the documents reviewed depends largely on the wishes of the Lender. Generally Delaware counsel will be asked to review the relevant note, mortgage instrument, and loan agreement, as well as other transaction or title documents, assignment or assumption documents, etc.

Contents of the Opinion Letter.

²⁰ <http://www.state.de.us/corp/frtax.shtml>

The opinion letter should provide the reader the sufficient background for the opinions rendered. Among other things, the letter should:

1. Describe the limited role of the opinion giver as special Delaware counsel.
2. Identify the client and all entities covered by the opinion and the role played by each such entity in the transaction, *i.e.*, borrower, leasing company, management company, member, guarantor, etc.
3. Identify any other entities and/or persons executing any of the documents.²¹
4. Identify all documents which were reviewed in order to generate the opinions set forth in the letter.²²
5. Be dated as of the date of the transaction.
6. Separately enumerate each and every opinion offered.
7. Describe all assumptions, limitations and qualifications.

²¹ The opinion letter should be careful to make certain that these entities and/or persons are not covered by the opinion.

²² Dates of some documents are relevant. They provide limitations as to the time frame of the opinion, *e.g.*, a "stale" Certificate of Good Standing should not be the basis of an opinion.