

## White Paper

# Delaware: Preferred Gateway to the U.S. Marketplace

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## I. Gateways to the U.S. Marketplace

The United States of America provides a large and lucrative market for goods and services. Not surprisingly, businesses based abroad often desire to pursue commercial opportunities in the United States. To facilitate entry into and operations in this market, "foreign" enterprises frequently use "domestic" entities as their vehicles for conducting business in the United States. Consequently, the formation of a new business entity, under the laws of one of the 50 states comprising the United States, usually is the first step to establishing a presence in that marketplace.

The U.S. legal system is comprised of national laws ("federal law") and the individual laws of each of the 50 states. Under this system, the formation of a business entity and the regulation of its internal affairs typically are governed by the law of a single state (in most cases, the state under the laws of which the business entity is organized), rather than by federal law.<sup>1</sup> Irrespective of which state is chosen as the "home state," a new business entity often can be set up in the United States at reasonable cost and in a timely manner. Enlisting the services of Corporation Service Company ([www.incspot.com](http://www.incspot.com)) can further simplify and expedite this process.

The selection of a business entity's home state, the laws of which will govern the business entity's internal affairs, is a paramount decision. Frequently, that choice is Delaware.

## II. Delaware is the Preferred Gateway

The state of Delaware provides a unique and favored gateway to the U.S. marketplace. More than 500,000 corporations, limited liability companies, statutory trusts, and partnerships have been formed in Delaware. That number, however, is only part of the story. Delaware is the corporate home state for many of the largest, most successful and best-known U.S. companies. Nearly 60% of the Fortune 500 companies are organized under Delaware law. Delaware corporations also constitute more than 50% of all U.S. publicly-traded companies.

## III. Why Delaware?

How does Delaware come to enjoy its reputation as the foremost "home state" in which businesses organize?

One reason is the advanced state of Delaware law. Business and legal professionals in the United States generally consider Delaware to have the most favorable, forward-looking laws regarding business entities. Delaware's statutory laws governing business entities are regularly reviewed and updated, with Delaware lawyers playing an active role in recommending and refining proposals for new legislation. Delaware also has a well-developed body of relevant judicial case law. This wealth of judicial decisions enables business decision-makers to plan with a greater degree of certainty and predictability.

Delaware's renowned court system is a major factor in the state's emergence as the premier corporate gateway to the United States. The Delaware Court of Chancery and the Delaware Supreme Court enjoy a worldwide reputation for excellence and fairness. The Court of Chancery is a court of equity that has existed for more than 200 years. The court regularly decides corporate, alternative entity, and other sophisticated business cases. Moreover, Delaware has no intermediate appellate court. Appeals are taken directly to the Delaware Supreme Court. This

structure results in expeditious review of trial court decisions. Delaware courts' experience with corporate and other business issues results in unparalleled expertise, which translates into efficient, prompt, fair, and more predictable resolution of disputes.

Another reason for Delaware's preeminence as a jurisdiction for business formation is its "business friendly" state government. Delaware's legislature and governor historically have demonstrated a willingness to understand and be responsive to the needs of business. Moreover, the Delaware Secretary of State's Office is a service-oriented organization. Businesses and others regularly take advantage of the flexibility and services offered by the Secretary of State's Office, including expedited document filing and processing; advanced document imaging and retrieval technology (reducing response time); document filings by fax; and remote access to the secretary of state's computer database by Delaware registered agents, such as Corporation Service Company.

Finally, U.S. business executives, professional advisors, investors, borrowers, lenders and rating agencies are familiar with and frequently have a favorable view of Delaware law, particularly as it relates to Delaware business entities. This level of acceptance among decision-makers in the U.S. capital and commercial markets is a major factor contributing to Delaware's status as the forum of choice in the United States for the formation of business entities.

#### **IV. Delaware Provides A Variety of Entity Choices**

The type of business organization one selects is among the first and most fundamental decisions to be made by business lawyers and their clients. A wide array of choices is available in Delaware. Different types of business entities may be formed to meet the needs of the enterprise and to establish the intended relationship among owners, creditors, and management. The various organizational forms available in Delaware include, among others, corporations, limited liability companies, and

statutory trusts. These three organizational forms are among those most frequently selected by business decision-makers and their advisors. Accordingly, the following is an overview of Delaware corporations, Delaware limited liability companies, and Delaware statutory trusts, with a brief description of some of the advantages offered by each entity.

## V. Delaware Corporations

Delaware's General Corporation Law (the "DGCL") provides the framework governing the formation and existence of Delaware corporations. Among other features, the DGCL offers flexibility, thereby creating opportunity. This flexibility extends to a number of important areas, such as ownership, management, and operations, thus allowing wide latitude for tailoring intra-corporate relationships. A Delaware corporation frequently may be structured in any manner that best accommodates the business needs of the parties.

### *Formation of a Delaware Corporation*

The formation of a Delaware corporation is a relatively simple process that includes two principal documents: the certificate of incorporation and the by-laws. The certificate of incorporation, the basic governing document for Delaware corporations, is a public document filed with the Delaware secretary of state. The filing of this document commences the legal existence of the corporation. The DGCL specifies certain items of information that must appear in the certificate of incorporation. The information required to be included in the document is narrow in scope, but the certificate of incorporation may include other desirable terms, thus permitting broad flexibility in the structure of the corporation. As it is not necessary to obtain judicial or regulatory approval for the incorporation (so long as the certificate of incorporation complies in form with the simple requirements of the DGCL), a Delaware corporation may be formed very quickly.

Unlike the certificate of incorporation, the by-laws of a Delaware corporation are not a matter of public record. The by-laws contain basic rules for conducting the corporation's business and affairs. Together, the by-laws and the certificate of incorporation provide guidance regarding matters of internal corporate governance.

#### *Stockholder Flexibility*

Under the DGCL, the term "stockholder" generally refers to a party with an ownership interest in the corporation. Economic and other rights may be allocated separately among stockholders by the creation of different classes of stock possessing different dividend and other economic preferences and different voting rights. If desired, parties also may provide for classes of non-voting stock. A common example of stockholder flexibility is the ability of parties under the DGCL to agree to specific super-majority stock-holder voting requirements regarding either a single matter or a wide variety of matters. Super-majority voting requirements often are used to protect the rights of a minority stockholder. Such provisions can be very useful in joint venture transactions in which the ownership interests of the parties are not equal.

Stockholders may vote at meetings of stockholders either in person or by written proxy. It is even possible for stockholders - who may be located throughout the world - to take action by written consent, without a formal meeting, and without having to be present in a single geographic location.

The DGCL permits parties to include in their certificate of incorporation a provision imposing on stockholders - to a specified extent and upon specified conditions - personal liability for the debts of the corporation. Absent such a provision, stockholders of a Delaware corporation generally are not personally liable for the payment of the corporation's debts. In addition, the names and addresses of stockholders need not be disclosed in the initial corporate filings made with the Delaware secretary of state, and there are no costly minimum capitalization requirements

imposed on stockholders under the DGCL. Stockholder flexibility, limited liability, and confidentiality are among the most important reasons businesses choose to organize their corporations in Delaware.

#### *Management Flexibility*

A Delaware corporation typically is managed by its board of directors, which designates and elects officers to carry out the daily operations of the entity. Unlike regulations applicable in some other jurisdictions, under Delaware law a single person can serve as the sole stockholder, director, and officer of the corporation. Though directors may hold meetings in person, the DGCL also permits directors to hold telephonic meetings and to act by written consent in lieu of a meeting. Indemnification and special protection against liability for officers and directors also is available under the DGCL. (For business or regulatory reasons a Delaware corporation may need one or more members of its board of directors to be "independent." In those situations, Entity Services Group LLC can help satisfy that need by providing to the corporation experienced, responsive individuals to serve as independent directors.)

#### *Geographic Flexibility*

A Delaware corporation may conduct business in any state in the United States and abroad. The "internal affairs doctrine," which provides that the law of the jurisdiction of incorporation governs the internal affairs of the corporation, provides certainty and reliability for Delaware corporations operating outside of Delaware. Furthermore, Delaware does not require a Delaware corporation to establish or maintain any place of business in Delaware, although it must have a registered agent and registered office within the state. (A service provider such as Corporation Service Company can serve as registered agent and provide a registered office or other situs services for a Delaware corporation at reasonable cost.)

#### *Ownership Flexibility*

The DGCL does not impose restrictions as to the citizenship of stockholders, officers, or directors of a Delaware corporation. Therefore, even a non-U.S. citizen may become a stockholder, officer, or director of a Delaware corporation.

#### *Business Transaction Flexibility*

The DGCL permits a Delaware corporation to engage in business transactions not only with unrelated third parties, but also with its stockholders, directors, and officers, as well as any subsidiary or parent company. It also may guarantee the obligations of its subsidiaries and its parent to third parties.

#### *Operational Flexibility*

To expand its business, and for many other reasons, a corporation sometimes will choose to amend its governing documents, merge or consolidate with another entity, convert to a different form of business entity, or conduct asset sales. Delaware law broadly enables Delaware corporations to engage in these and other types of transactions.

## **VI. Delaware Limited Liability Companies**

Delaware has emerged as a leader in providing cutting-edge alternatives to the traditional corporation. One example of this leadership is Delaware's enactment of the Delaware Limited Liability Company Act (the "DLLC Act"), which governs the most popular "alternative" business entity, the Delaware limited liability company ("DLLC"). The DLLC is rapidly becoming an entity of choice for business advisors and investors, and can provide tax advantages (and in some cases, business advantages) over the corporation.

A DLLC may pursue almost any lawful business activity, including manufacturing, services, holding and developing real estate, and holding and managing intangible property such as securities and other

investments. The principal advantages of a DLLC are avoidance of double income taxation, unmatched contractual flexibility, and limited liability. A DLLC may be structured in virtually any manner that best suits the business needs of the parties. This flexibility can make the DLLC preferable to the traditional corporation and, in many cases, to other alternative business entities such as limited partnerships or general partnerships.

#### *Formation of a DLLC*

A DLLC is easy to form and maintain. Formation of a DLLC requires only: (1) a limited liability company agreement of the member or members (which need not be written); and (2) the filing of a certificate of formation with the Delaware Secretary of State. A DLLC is deemed to have been formed at the time the certificate of formation is filed with the Delaware secretary of state. The certificate of formation must set forth only the name of the DLLC and the name and address of the DLLC's registered agent and registered office in Delaware, and it may also contain any other matters that the members determine to include therein.

A limited liability company agreement is a private contract. It is not a public document. Therefore, under the DLLC Act the identity of a DLLC's owners and managers, and the terms of their relationships, can remain confidential. The DLLC Act does not specify any minimum capital investment. Non-U.S. businesses and individuals generally are free to form and operate DLLCs because the DLLC Act does not require an owner or manager of a DLLC to be a natural person or a citizen or resident of the United States. Additionally, a DLLC's records need not be located in Delaware. They may be located wherever is most convenient for the parties, including any jurisdiction outside the United States. Furthermore, such records may be maintained in electronic or other non-written form.

#### *No Delaware Business Activities Required*



There is no requirement that a DLLC carry on business activities or establish or maintain any place of business (other than a registered agent and registered office) in Delaware. (Corporation Service Company, a globally recognized service provider, makes the registered agent/registered office requirement an easy one to satisfy.)

#### *Limited Liability*

The DLLC Act generally refers to owners of a DLLC as "members," and to persons designated to manage the business and affairs of the entity as "managers." The DLLC Act permits a DLLC to be managed by its members, without requiring such members to be managers. The DLLC Act provides that no member or manager is liable personally for any debt, obligation, or liability of a DLLC solely by virtue of such party's status as a member or manager. In addition, the DLLC Act expressly empowers a DLLC to "indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever." This limitation on personal liability and the broad scope of permissible indemnification compare favorably with the corresponding protections enjoyed by stockholders, officers, and directors of a Delaware corporation.

#### **Contractual Flexibility**

The basic approach of the DLLC Act is to let the parties define their business relationship in the limited liability company agreement, and to provide rules only for those matters on which the parties have failed to agree. A stated policy of the DLLC Act is to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements. This important policy means that the parties can predictably create and maintain the relationships that best suit their business needs. For instance, in their limited liability company agreement, the parties may provide for various classes of members (with each class enjoying different rights, powers, and duties, including separate voting rights and economic rights). In fact, the parties may by

agreement determine nearly all aspects of their relationship with one another. To the extent that a member or manager has duties (including fiduciary duties) to the DLLC or to another member or manager, the DLLC Act provides that the limited liability company agreement may expand or restrict or eliminate such duties (other than the implied contractual covenant of good faith and fair dealing). This flexibility arises from Delaware's longstanding policy favoring freedom of contract.

#### *Management Flexibility*

The principle of contractual freedom manifests itself particularly in management flexibility, a cornerstone of the DLLC Act. The parties can select the management arrangement that works best for them. Under the DLLC Act, members of a DLLC can participate in management without jeopardizing their limited liability, or they may elect to have the DLLC managed by someone else, or fashion a blend of these two approaches. The limited liability company agreement may provide for different classes of managers, each having such rights, powers, and duties as are provided therein. The limited liability company agreement also may contain provisions relating to the exercise of voting rights, including provisions relating to notice of the time, place, or purpose of any meeting at which any matter is to be voted on, waiver of any such notice, action by consent without a meeting, quorum requirements, and rules for voting in person or by proxy. Members and managers of a DLLC generally are free to transact business with the DLLC. (Whenever needed [e.g., for a business reason such as satisfying the requirements of a lender to the DLLC], CSC Trust Company of Delaware can serve as administrator or "independent" manager of a DLLC, and it has a broad range of experience in serving in those capacities.)

#### *Business Combination Flexibility*

In addition to flexibility at the creation and operational stages of a DLLC's existence, the DLLC Act offers the parties a number of ways to restructure the DLLC. For example, under the DLLC Act, a DLLC may

merge or consolidate with another DLLC, or with an "other business entity" (including, but not limited to, corporations, statutory trusts, and partnerships), whether any such other business entity is formed or organized under the laws of Delaware or another jurisdiction. Delaware offers additional flexibility by permitting reorganization of a DLLC by way of asset sales, "conversions," "transfers," and "domestications."

#### *Avoidance of Double Taxation*

As a matter of U.S. federal income tax law, a DLLC may be structured so that it will not be subject to tax at the business organization level. Therefore from a tax perspective the DLLC offers a very attractive alternative to the corporation, which typically is taxed at the organization level. The members of a DLLC may specifically agree to such tax treatment in their limited liability company agreement. Of course, the contractual freedom afforded by the DLLC Act enables the members to agree to other tax treatment if they so desire.

## **VII. Delaware Statutory Trusts**

Another frequently utilized "alternative entity" is the Delaware statutory trust ("DST"). The DST has become an efficient and popular mechanism for the preservation of property and the conduct of business. In particular, DSTs are widely viewed as the preferred vehicles for certain structured finance transactions such as asset securitizations.

One major advantage that a DST has over a common law trust is a comprehensive statutory framework: the Delaware Statutory Trust Act (the "DST Act"), which authorizes the creation of DSTs and provides specific rules governing a DST's internal affairs. The DST Act provides that a DST is a separate legal entity, and may carry on any lawful business or purpose. Except to the extent otherwise provided in its governing instrument, a DST has perpetual existence, and the death,

incapacity, dissolution, termination or bankruptcy of a beneficial owner will not result in the termination or dissolution of the DST.

#### *Formation of a DST*

A DST is formed by the filing of a certificate of trust with the Delaware secretary of state and the parties' entering into a governing instrument. The certificate of trust need only set forth the name of the DST and the name and business address of at least one trustee who is a resident of, or has a principal place of business in, Delaware. (A Delaware based trust company such as CSC Trust Company not only can satisfy the Delaware trustee requirement, but also can provide administrative, management and other useful services as desired by the parties.) The governing instrument may include one or more documents containing provisions relating to the business of the DST, the conduct of its affairs and its rights or powers, and the rights or powers of its trustees, beneficial owners, agents or employees.

#### *Ownership Flexibility*

The interests of the beneficial owners of a DST may be evidenced by the issuance of trust certificates or by book entry registration, in conformity with the applicable provisions of the governing instrument. Except to the extent otherwise provided for in the governing instrument, the beneficial owners are entitled to the same limitation of personal liability extended to stockholders of Delaware corporations. A beneficial owner typically is entitled to an undivided beneficial interest in the property of the DST and may share in the profits and losses of the DST in the manner set forth in the governing instrument. A beneficial owner's interest in a DST is deemed to be personal property notwithstanding the nature of the property held by the DST.

#### *Management Flexibility*

The business and affairs of a DST normally are managed by its trustees, but a governing instrument may provide for management of the DST in

whole or in part by beneficial owners or other persons. A trustee acting as such is not personally liable for the obligations of the DST. The governing instrument may contain any other provision relating to the management of the business and affairs of the DST, and may also contain other provisions defining the rights, duties and obligations of the beneficial owners, the trustees, and any other person managing the business and affairs of the DST. The governing instrument may also provide for the taking of any action, including the amendment of the governing instrument, the accomplishment of a merger or consolidation, the conversion of the DST to another form of Delaware business entity, or the sale or other disposition of all or any part of the trust property, with or without the vote or approval of any particular trustee or beneficial owner, as the parties may desire.

#### *Business Combination Flexibility*

A DST may merge or consolidate with another DST or with an "other business entity" (including, but not limited to, corporations, limited liability companies, and partnerships), whether such other business entity is existing under Delaware law or the laws of another jurisdiction. A DST also may be converted to another form of Delaware business entity. Unless otherwise provided in the governing instrument, a merger or consolidation or a conversion must be approved by all of the trustees and all of the beneficial owners.

### **VIII. Conclusion**

The business entity selected as the vehicle to access the U.S. marketplace should meet the requirements of the specific business enterprise and further the achievement of its particular goals. Whatever those requirements and goals may be, and however large or small the business venture, many legal and business professionals view Delaware as the foremost jurisdiction for establishing a business entity to conduct business in the U.S. marketplace.

## ABOUT THE AUTHORS

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## ABOUT CSC

Corporation Service Company, a privately-held company headquartered in Wilmington, DE, USA, is a leading provider of legal and financial services for many of the world's largest companies, law firms and financial institutions. Founded in 1899, CSC is a service company dedicated to reducing risks and costs for our clients by providing corporate identity protection; corporate governance and compliance; litigation and matter management; as well as deal and transaction support services. Each of the services offered by CSC is fully integrated with our monitoring, workflow, compliance and reporting solutions. To learn more about CSC, visit [www.cscglobal.com](http://www.cscglobal.com).

<sup>1</sup>Undoubtedly, federal law issues may arise in connection with the formation by a "foreign" owner of a business entity in the United States (e.g., reporting requirements), but knowledgeable U.S. counsel can assist in addressing these matters.