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Delaware Court of Chancery Confirms Fiduciary Duties of Managers of Delaware LLCs as Default Standard

Delaware is a favored forum for German companies and their subsidiaries when forming a limited liability company (“LLC”) for joint venture purposes. However, care must be taken in forming the joint venture to fully benefit from the legal structure. In a recent decision, the Delaware Court of Chancery re-affirmed that fiduciary duty principles will apply to managers of a Delaware LLC unless those duties are expressly and clearly limited or eliminated in the LLC agreement.

In *Auriga Capital Corp. v. Gatz Properties LLC et al*, C.A. No. 4390-CS (Del. Ch., Jan. 27, 2012), Chancellor Strine found that the majority owner and manager of Peconic Bay LLC (“Peconic Bay”) breached its fiduciary duties when it attempted to squeeze out the minority members in bad faith. Peconic Bay was formed by Gatz Properties LLC, plaintiff Auriga Capital Corporation and other investors to develop and operate a golf course. William Gatz, through his ownership in Gatz Properties LLC, held a majority stake in Peconic Bay and essentially acted as manager of the company. The land on which the golf course was located was owned by Gatz and his family which leased the land to Peconic Bay. In turn, Peconic Bay entered into a thirty-five year lease agreement with a management company to manage the golf course. Due to the poor performance of the management company, it became apparent to Gatz as early as 2004 that the management company would exercise its option to terminate its lease early in 2010.

The decision reflects that instead of attempting to find a new lessee or explore alternative investment strategies for Peconic Bay, Gatz decided to take advantage of this opportunity and to buy-out the minority members of Peconic Bay at a low price. The Court found that Gatz, among other things, (i) actively discouraged potential buyers and failed to provide them with due diligence information; (ii) provided the minority investors with misleading information regarding his negotiations with potential buyers; and (iii) conducted a sham auction to sell Peconic Bay in which he was the only bidder.

The Court held that fiduciary duties generally apply to LLC managers even though the Delaware Limited Liability Act does not expressly provide for them. Rather, the Delaware Limited Liability Act authorizes that traditional duties of loyalty and care apply through the principles of equity for any case not provided for in the Act. However, the Court emphasized that it will recognize an expansion, restriction or elimination of such duties if specifically set forth in a company’s LLC agreement. The Court in *Auriga* held that the language in Peconic Bay’s LLC agreement excluding liability for actions taken



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in good faith and in a manner reasonably within the scope of authority conferred on the manager did not insulate the manager from liability. The actions taken were not within the scope of authority granted to the manager under the LLC Agreement since they violated a covenant requiring that any affiliated transactions are conducted on an arm's length basis and were also taken in bad faith.

Auriga cautions parties to a joint venture in the form of a Delaware LLC to consider the appropriate scope of a manager's fiduciary duties to the LLC members, and include clear and unambiguous language in the LLC agreement when trying to restrict or eliminate, or enlarge, as the facts and circumstances warrant, the standard fiduciary duties.

