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Litigation Considerations in Real Estate Transactions, Part 2: Use of Delaware Limited Liability Companies
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This article—the second in a three-part series examining common features of real estate transactions that can benefit from a litigation analysis in the negotiation phase—focuses on two of those aspects: statutes of limitations and waivers of duties.

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The Delaware limited liability company (LLC) is a popular form of business organization in New York real estate. But parties who choose to use a Delaware LLC to own, manage, or invest in New York real estate need to be prepared for the application of Delaware substantive law to certain aspects of any dispute that may later arise, even if the dispute is litigated in New York. This article – the second in a three-part series examining common features of real estate transactions that can benefit from a litigation analysis in the negotiation phase – focuses on two of those aspects: statutes of limitations and waivers of duties.

Statutes of Limitations

Parties who choose to use Delaware LLCs to invest in New York real estate projects need to be aware that such use may result in the application of a substantially shorter statute of limitations to claims arising from the investment. In particular, although New York’s statute of limitations for breach of contract claims is six years (CPLR 213(2)), Delaware’s is only three years. *See* 10 Del.C. § 8106(a). A claim by a Delaware LLC arising from its investment in New York real estate may be subject to that substantially shorter limitations period.

This is because under New York law a claim based on economic harm is subject to the statute of limitations of the state of the plaintiff’s residence, even if the claim is asserted under a contract that is governed by the substantive law of another state. *See U.S. Educ. Loan Trust IV, LLC v. Bank of NY Mellon*, 179 A.D.3d 447, 448 (1st Dept. 2020). If an investor organized under

the laws of Delaware does no business other than maintaining passive real estate investments, it may be deemed a resident of Delaware for this purpose – with the result that any claims arising from those investments are subject to Delaware’s statute of limitations. *See Interventure 77 Hudson LLC v. Falcon Real Estate Investment Cor.*, 172 A.D.3d 481 (1st Dept. 2019).

Importantly, registering to do business in New York is not enough to make a Delaware company a New York resident for limitations purposes, even in tandem with an “extensive presence here.” *Verizon Directories Corp. v. Continuum Health Partners, Inc.*, 74 A.D.3d 416, 416-17 (1st Dept. 2010). If the company’s *sole* business is owning property in New York, however, it might get the benefit of the longer New York statute of limitations by claiming New York as its “principal place of business.” *See, e.g., Oxbow Calcining USA Inc. v. American Indus. Partners*, 96 A.D.3d 646, 651 (1st Dept. 2012).

What is the takeaway? The possibility that a shorter statute of limitations might apply to future claims is certainly not itself a reason to eschew the use of a Delaware LLC. Moreover, unlike New York law (which permits parties to contractually *shorten* a limitations period before cause of action has accrued, but not to lengthen it – *see* CPLR 201), Delaware law permits the parties to an agreement to specify a limitations period of as long as 20 years for actions “based on a written contract, agreement or undertaking involving at least \$100,000.” *See* 10 Del.C. § 8106(c). As a result, it may be possible to eliminate or minimize this problem (at least with respect to any claim for breach of contract that would otherwise be subject to a Delaware statute of limitations) if the counter-party is willing to agree to specify a contractual limitations period that is longer than Delaware’s three-year statute. Such a provision should be enforceable in New York as long as the contractual period does not exceed New York’s six-year statute. *See* CPLR 202. In the absence of such a negotiated limitations period, however, a party who invests in New

York real estate through a Delaware LLC should be prepared to act quickly in connection with any possible claim, rather than resting on the potentially-false assumption that New York's long limitations period will apply.

Waiver of Duties

The statute of limitations concerns discussed above relate to the rights of a Delaware entity that enters into a New York real estate transaction. But what of the rights of the parties who choose to organize themselves as a Delaware LLC for the purpose of owning or developing property? Here too there are important differences between Delaware law and New York law that parties should bear in mind when they choose this entity structure. Notable among these is the extent to which duties may be waived.

New York law expressly limits such waivers. A limited liability company's operating agreement may not eliminate "the liability of any manager if a judgment or other final adjudication adverse to him or her establishes that his or her acts or omissions were in bad faith or involved intentional misconduct or a knowing violation of law or that he or she personally gained in fact a financial profit or other advantage to which he or she was not legally entitled." N.Y. Limited Liability Company Law § 417(a)(1). This has been interpreted to mean that the managers of a New York limited liability company cannot be contractually relieved of liability for a "bad faith" breach of fiduciary duty. *See John v. Varughese*, 194 A.D.3d 799, 801 (2d Dept. 2021); *accord Howard v. Pooler*, 184 A.D.3d 1160, 1165 (4th Dept. 2020). As it is difficult to imagine a breach of fiduciary duty that does not involve some element of bad faith (*see Biondi v. Beekman Hill House Apt. Corp.*, 94 N.Y.2d 659, 666-67 (2000)), as a practical matter this means that an attempt to waive the fiduciary duties owed by managers of a New York

LLC will “most likely” be “ineffective.” 4D N.Y. Prac., Comm. Litig. in New York State Courts, § 104:22 (noting that “[t]he courts of New York have not widely addressed the issue”).

Delaware law, in contrast, expressly permits the members of a limited liability company to “expand[] or restrict[] or eliminate[]” any duties, “including fiduciary duties” – provided only that “the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.” 6 Del.C. § 18-1101(c). It further allows members to limit or eliminate “any and all liabilities for breach of contract and breach of duties (including fiduciary duties)” *except* for “a bad faith violation of the implied contractual covenant of good faith and fair dealing.” 6 Del.C. § 18-1101(e). The implied contractual covenant of good faith and fair dealing has nothing to do with fiduciary duties; it is a contract principle that addresses “contractual gaps” that “neither party anticipated.” *Nemec v. Shrader*, 991 A.2d 1120, 1125-26 (Del. 2010).

Delaware law thus makes clear that, unlike the members of a New York LLC, the members of a Delaware LLC may agree to absolve their managers of fiduciary duties. Despite the limits that New York law imposes on such waivers, the state’s courts regularly enforce them when they are contained in the operating agreement of a Delaware LLC that specifies that it is governed by Delaware law. *See, e.g., 111 W. 57th Inv. LLC v. 111 W57 Mezz Inv. LLC*, 192 A.D.3d 618 (1st Dept. 2021); *Kagan v. HMC-New York, Inc.*, 94 A.D.3d 67 (1st Dept. 2012).

What does this mean for parties who choose to organize themselves as a Delaware LLC for the purpose of a New York real estate transaction? It is critical to pay close attention to the operating agreement’s provisions respecting fiduciary and other duties. If the operating agreement waives such duties, that waiver is likely to be enforced pursuant to its terms – as numerous plaintiffs who have attempted to sue for breach of fiduciary duty in the face of such

waivers have learned. A party who wants to preserve some level of fiduciary duty on the part of the LLC's managers should therefore insist that any waiver of such duty be expressly limited or contain exceptions.

Conclusion

The decision to use a Delaware LLC is generally driven by business considerations that likely transcend any concern about statutes of limitations or the effectiveness of waivers of fiduciary duties, especially if the transaction and the resulting relationship go as the parties hope. But if anything goes awry, these issues may quickly come to the fore – and parties who have paid careful attention to them will be much better prepared to effectively protect their rights.

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