Delaware LLCs in NY Real Estate Transactions: Part 1: Basic Considerations
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In the first of her four-part series, Adrienne Koch of Katsky Korins discusses issues surrounding the use of Delaware LLCs for real estate transactions in New York. She examines some of the general factors that should be taken into account in choosing that entity form for such transactions. Future articles in the series will discuss some of the other implications and consequences of that choice.

By Adrienne B. Koch

Real estate transactions frequently involve Delaware limited liability companies (LLCs), which are considered by many to be an attractive form of business entity. This article—the first in a four-part series that will focus on issues surrounding the use of Delaware LLCs for real estate transactions in New York—will discuss some of the general factors that should be taken into account in choosing that entity form for such transactions. Future articles in the series will discuss some of the other implications and consequences of that choice.

Why Delaware?

Parties choose to organize their entities as Delaware LLCs for a variety of reasons. One of them is that Delaware is highly conscious of—and works to maintain—its status as a venue of choice for entity formation. As a result, the Delaware legislature is responsive to the legal and business community and acts quickly to update the statutory scheme to address case law developments and respond to other concerns. Delaware's commitment to remaining current in this regard is in itself a positive feature.

There are also a number of specific distinctions between Delaware law and New York law that may make Delaware more appealing. For example, Delaware offers greater flexibility than most other states (including New York) in allowing the members of an LLC to determine contractually what duties they will and will not have to one another.

Under New York law, a limited liability company's operating agreement may not relieve a manager of a "bad faith" breach of fiduciary duty. N.Y. Limited Liability Company Law §417(a)(1); *see* J*ohn 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, 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); *see* 6 Del.C. §18-1101(e).

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. Importantly, New York courts will enforce these waivers if they are contained in the operating agreement of a Delaware LLC that specifies that it is governed by Delaware law. *See*, e.g., 1*11 W. 57th Inv. LLC v. 111W57 Mezz Inv. LLC*, 192 A.D.3d 618, 621 (1st Dept. 2021); *Kagan v. HMC-New York, Inc.*, 94 A.D.3d 67, 72 (1st Dept. 2012).

Delaware law is also more friendly to the managers of an LLC when it comes to indemnification. In *Stifel Financial Corp. v. Cochran*, 809 A.2d 555 (Del. 2002), the Supreme Court of Delaware held that where a corporate director prevails in a suit against the corporation to enforce a contractual right to indemnification, the director is entitled to be reimbursed for any legal fees and costs incurred in connection with the suit unless the governing documents specifically provide otherwise.

The court's reasoning was straightforward: "Allowing indemnification for the expenses incurred by a director in pursuing his indemnification rights gives recognition to the reality that the corporation itself is responsible for putting the director through the process of litigation."809 A.2d at 561. This rule has been held applicable to managers of a Delaware LLC as well. *See GMF ELCM Fund L.P. v. ELCM HCRE GP LLC*, 2021 WL 4313430, *9 (Del. Ch. Sept. 22, 2021) (collecting cases).

In New York, however, the rule is exactly the opposite: absent a specific provision entitling an LLC manager to reimbursement for attorney fees incurred in seeking to enforce a right to be indemnified by the LLC, such fees are not recoverable. *See 546-552 West 146th Street LLC v. Arfa*, 99 A.D.3d 117, 119-23 (1st Dept. 1999) (specifically refusing to adopt the Stifel rationale). It appears likely that a New York court will apply the Delaware rule to a Delaware entity, although the law on this point is somewhat less fully developed. *See Drone USA, Inc. v. Antonelos*, 2023 WL 1864384, *3 (Sup. Ct. N.Y. Cnty. Feb. 9, 2023).

Some Caveats

The discussion above illustrates some of the many reasons why parties might choose to organize their entities as Delaware LLCs. But where the purpose of the entity is to engage in a New York real estate transaction, there are other issues to bear in mind in making that choice.

For one thing, any entity whose key purpose is to engage in a New York real estate transaction is likely to be doing business in New York for purposes of New York Limited Liability Company Law §802. That statute requires all non-New York LLCs that do business in New York to apply for and obtain authority to do so from the New York Secretary of State. As a result, a Delaware

LLC that wishes to do business in New York must make filings (and incur associated fees) in both states. It will also almost certainly need to have an agent for service of process in each state. All of this adds a layer of bureaucracy and expense.

There are other requirements for doing business in New York that will apply equally to a Delaware LLC. For example, any LLC that wishes to do business in New York (regardless of where it is formed) must publish its application "or a notice containing the substance thereof" once a week for six successive weeks in two newspapers. *See* N.Y. LLC Law §802(b). Using a Delaware LLC will not enable parties to a New York real estate transaction to escape this requirement.

In addition, under New York's LLC Transparency Act—scheduled to take effect Jan. 1, 2026—all LLCs that do business in New York (regardless of where they are formed) will have to file a "beneficial ownership disclosure" with New York's secretary of state, setting forth the name, address, and date of birth of each "beneficial owner" of the LLC. *See* L.2024, ch. 102, §§1106-08. The statute borrows the definition of "beneficial owner" from 31 U.S.C. §5526(a)(3), which defines the term to mean any individual who directly or indirectly either "exercises substantial control over the entity" or "owns or controls not less than 25 percent of the ownership interests of the entity."

Information respecting "beneficial owners who are natural persons" will be kept confidential, but may be disclosed for certain purposes—including pursuant to a court order or "for a valid law enforcement purpose." L.2024, ch. 102, §1107(f).Importantly, although there is a federal Corporate Transparency Act that would require similar reporting at the national level, implementation of that reporting requirement has been suspended due to litigation. (*See https://fincen.gov/boi*).

The New York statute is not subject to any such suspension, and using a Delaware LLC will not enable parties to a New York real estate transaction to escape its requirements once it takes effect.

Conclusion

There are many features of a Delaware LLC that make it an attractive entity form. But when considering using it for a New York real estate transaction, it is important to remember that it does not relieve parties of certain key obligations associated with doing business in this state—including obligations that may be time-consuming and expensive. Organizing under Delaware law rather than under New York law adds to that time and expense. If the transaction is sufficiently substantial, however, that additional time and expense may be fully worthwhile.

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