

**LIMITED LIABILITY COMPANY LAW – WHETHER A MANAGER OF
A MANAGER-MANAGED LIMITED LIABILITY COMPANY
BREACHED FIDUCIARY DUTIES UNDER DELAWARE LAW TO THE
LIMITED LIABILITY COMPANY AND ITS MEMBERS**

By Robert Arthur*

Gatz Props., LLC v. Auriga Capital Corp., 59 A.3d 1206 (Del. 2012).

In *Gatz Properties, LLC v. Auriga Capital Corporation*,¹ the Supreme Court of Delaware recently affirmed in a per curiam opinion a decision of the Delaware Court of Chancery, in which the Court of Chancery concluded that the manager of a manager-managed limited liability company (LLC) was subject to liability for damages for breach of fiduciary duty.² The Delaware Supreme Court’s opinion is significant because it instructs lower courts to disregard the Court of Chancery’s conclusion that an LLC’s manager owes fiduciary duties under the Delaware LLC statute except to the extent that the parties displace those duties by contract.³ The Delaware Supreme Court expressly left undecided the issue whether an LLC manager owes fiduciary duties by default under the Delaware LLC statute and stated that the issue “is one about which reasonable minds could differ.”⁴

In *Gatz*, William Gatz sought to develop a piece of land owned by the Gatz family in order to build a golf course on it.⁵ Acting through Gatz Properties, LLC (Gatz Properties), he joined with Auriga Capital Corp. and other minority investors to form Peconic Bay, LLC (Peconic Bay), a Delaware limited liability company.⁶ The Amended and Restated Limited Liability Company Agreement (LLC Agreement) of Peconic Bay designated Gatz Properties as Peconic Bay’s manager.⁷ William Gatz managed, controlled, and partially owned Gatz Properties, and thus effectively served as manager of Peconic Bay.⁸ The Gatz family and their affiliates owned over 85% of the Class A membership interests and over 52% of the Class B membership interests of Peconic Bay.⁹

Gatz Properties leased the family property to Peconic Bay under a long-term ground lease.¹⁰ As contemplated by the LLC Agreement, Peconic Bay entered into a long-term sublease with American Golf Corporation, a national golf course operator.¹¹ The term of the sublease was thirty-five years, with American Golf having the option to terminate the contract after the tenth year of its operation.¹² American Golf agreed to pay rent starting at \$700,000 per year as well as additional rent in the amount of 5% of the revenue from its golf course

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¹ *Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206 (Del. 2012).

² *Id.* at 1218.

³ *Id.* (stating “that court’s statutory pronouncements must be regarded as dictum without any precedential value”).

⁴ *Id.* at 1219.

⁵ *Id.* at 1208–09.

⁶ *Id.* at 1208.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1209 (Del. 2012).

¹¹ *Id.*

¹² *Id.*

operations.¹³ American Golf neglected maintenance to the point that the golf course was in extremely poor condition.¹⁴ The golf course's operations were never profitable and, by at least 2005, it became clear that American Golf would exercise its option to terminate the lease in 2010.¹⁵ Aware of the likelihood of termination, Gatz hired an appraiser in 2005 who valued the land at \$10.1 million with golf course improvements and \$15 million as vacant land available for development.¹⁶

In August 2007, Matthew Galvin, on behalf of RDC Golf Group, Inc., approached Gatz with an offer to acquire Peconic Bay's long-term lease.¹⁷ Gatz submitted Galvin's offers of \$3.75 million and \$4.15 million to votes of Peconic Bay's members, but the members rejected each offer.¹⁸ William Carr of Auriga Capital suggested that Gatz ask Galvin if he would be interested in a deal at \$6 million.¹⁹ Gatz contacted Galvin and suggested that no further discussions would be fruitful unless Galvin was willing to discuss a number "*well north* of \$6 million."²⁰ Galvin indicated that he may have an interest in proceeding on those terms, but Gatz did not respond to Galvin's requests to negotiate.²¹ Despite Galvin's continued interest, Gatz told the minority members of Peconic Bay that negotiations between the parties had broken off with RDC Golf Group's best offer of \$4.15 million.²²

In January 2008, Gatz offered to purchase the interests of Peconic Bay's minority members for an amount equal to the distribution each member would receive if Peconic Bay sold its assets for a cash price of \$5.6 million.²³ Under this proposal, the minority members would have received \$734,131 for their membership interests in Peconic Bay.²⁴ Gatz suggested that this amount would be equivalent to selling Peconic Bay's assets for over \$6 million since the transaction would not result in closing costs or prepayment penalties that would apply in a sale to a third party.²⁵ All minority members of Peconic Bay except one rejected Gatz's offer.²⁶ Because Gatz had conditioned his offer on unanimous acceptance by the minority members, Gatz's offer to purchase did not proceed.²⁷

Intent on finding a way to purchase the minority members' interests, Gatz decided to take another approach and get a second appraisal on the property.²⁸ This time he did not inform the appraiser of American Golf's shortcomings as a course operator, or Galvin's offers and high revenue projections.²⁹ As a result, the appraiser relied solely on American Golf's financial records and data from comparable golf courses.³⁰ The appraiser found that the value of the

¹³ *Id.*

¹⁴ *Id.*

¹⁵ Gatz Props., LLC v. Auriga Capital Corp., 59 A.3d 1206, 1209 (Del. 2012).

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 1210.

²⁰ *Id.* (emphasis added).

²¹ *Id.*

²² Gatz Props., LLC v. Auriga Capital Corp., 59 A.3d 1206, 1210 (Del. 2012).

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ Gatz Props., LLC v. Auriga Capital Corp., 59 A.3d 1206, 1210 (Del. 2012).

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

property was somewhere between \$2.8 and \$3.9 million.³¹ Following a second offer to the minority members, Gatz informed the minority members that Peconic Bay would be sold at auction and that Gatz Properties would bid.³² Gatz retained an auctioneer with experience mainly in bankruptcy court proceedings and that had never auctioned a golf course.³³ The auction was marketed in small-print classified advertisements in general circulation newspapers and a few magazines, online ads and direct mailings.³⁴ No golf course brokers, managers, or operators were ever contacted.³⁵ Gatz, on behalf of Gatz Properties, was the only bidder to show up to the auction.³⁶ He purchased Peconic Bay for \$50,000 plus the assumption of the LLC's debt. The minority members of Peconic Bay collectively received \$20,985.³⁷

The minority members of Peconic Bay sued Gatz and Gatz Properties alleging they breached their contractual duties under the LLC Agreement and breached their fiduciary duties to the LLC and its minority members.³⁸

Delaware Court of Chancery. The Court of Chancery began its analysis by interpreting the LLC Agreement.³⁹ Section 15 of the LLC Agreement provided:

Neither the Manager nor any other Member shall be entitled to cause the Company to enter into any amendment of any of the Initial Affiliate Agreements which would increase the amounts paid by the Company pursuant thereto, or enter into any additional agreements with affiliates on terms and conditions which are less favorable to the Company than the terms and conditions of similar agreements which could then be entered into with arms-length third parties, without the consent of a majority of the non-affiliated Members (such majority to be deemed to be the holders of 66-2/3% of all Interests which are not held by affiliates of the person or entity that would be a party to the proposed agreement).⁴⁰

The Court of Chancery concluded that Section 15 imposes fiduciary duties in transactions between the LLC and affiliated persons.⁴¹ Specifically, the Court of Chancery reasoned that Section 15 permits Gatz to engage in a self-dealing transaction with the LLC without the approval of the minority members if the price is equivalent to the price that would be negotiated in a transaction with an unrelated third party, i.e., a fair price.⁴² According to the court, Section 15 imposes on Gatz the burden of proving that he paid a fair price, determined by a reasonable examination of what a third-party buyer would pay for the Peconic Bay.⁴³ The Court of Chancery concluded that the entire record, including Gatz's failure to negotiate with an interested good faith buyer, indicates that Gatz failed to meet his burden and therefore breached his fiduciary duties to the LLC and the minority members.⁴⁴

³¹ *Id.*

³² Gatz Props., LLC v. Auriga Capital Corp., 59 A.3d 1206, 1211 (Del. 2012).

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 1212.

³⁷ *Id.*

³⁸ *Id.*

³⁹ Auriga Capital Corp. v. Gatz Props., LLC, 40 A.3d 839, 849 (Del. Ch. 2012).

⁴⁰ *Id.* at 857.

⁴¹ *Id.* at 858.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

The Court of Chancery's opinion is significant because it concludes that a manager of a manager-managed LLC owes to the LLC and its members fiduciary duties by default under the Delaware LLC statute, i.e., fiduciary duties that apply except to the extent displaced by contract.⁴⁵ The court recognized that the Delaware Limited Liability Company Act does not "plainly state" that LLC managers owe fiduciary duties, but noted that the same is true of the Delaware General Corporation Law, which the Delaware Supreme Court has stated must be "read in concert with equitable fiduciary duties."⁴⁶ The Court of Chancery reasoned that the statutory language of the Delaware Limited Liability Company Act is more explicit regarding the application of equitable principles because it states that "the rules of law and equity . . . shall govern."⁴⁷ The Delaware Limited Liability Company Act also permits "elimination of default fiduciary duties"⁴⁸ in the LLC Agreement, which the Court reasoned would be an unnecessary provision if fiduciary duties did not apply absent their contractual adoption.⁴⁹ The Court of Chancery concluded that, by enacting these provisions, the Delaware General Assembly had indicated that "[d]efault fiduciary duties do apply in the LLC context to the extent they are not contractually altered."⁵⁰

Delaware Supreme Court. The Delaware Supreme Court agreed with the Court of Chancery's conclusion that Section 15 of Peconic Bay's LLC Agreement imposes fiduciary duties in transactions between the LLC and affiliated persons.⁵¹ The Delaware Supreme Court reasoned that, although Section 15 does not use the terms "entire fairness" or "fiduciary duties," when "[v]iewed functionally, the quoted language is the contractual equivalent of the entire fairness equitable standard of conduct and judicial review."⁵² The Delaware Supreme Court upheld the Court of Chancery's determination that Gatz breached the fiduciary duties contractually adopted by Section 15 of the LLC Agreement.⁵³

Although it affirmed the result, the Delaware Supreme Court admonished the Court of Chancery for addressing the issue whether the Delaware LLC statute imposes fiduciary duties by default on LLC managers.⁵⁴ The Delaware Supreme Court stated that reaching the "default fiduciary duty issue" was unnecessary, and any statutory pronouncements in the Court of Chancery's opinion pertaining to default fiduciary duties should be "regarded as dictum without any precedential value."⁵⁵ Despite a well-reasoned opinion by the Court of Chancery, the Delaware Supreme Court expressly left the issue open, stating that "the merits of the issue whether the LLC statute does—or does not—impose default fiduciary duties is one about which reasonable minds could differ."⁵⁶

⁴⁵ *Id.* at 851.

⁴⁶ *Id.* at 849.

⁴⁷ *Id.* (citing DEL. CODE ANN. tit. 6, § 18-1104 (West 1992)).

⁴⁸ *Id.* at 851 (citing 74 Del. Laws 275 § 13 (2004)).

⁴⁹ *Id.* at 852.

⁵⁰ *Id.*

⁵¹ Gatz Props., LLC v. Auriga Capital Corp., 59 A.3d 1206, 1213 (Del. 2012).

⁵² *Id.*

⁵³ *Id.* at 1214.

⁵⁴ *Id.* at 1218.

⁵⁵ *Id.*

⁵⁶ *Id.* at 1219.