Damning Dictum: The Default Duty Debate in Delaware

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COMPROMISING LLC LAW AND Dictum: THE DEFAULT DUTY DEBATE IN DELAWARE

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Abstract

Bizarrely, today even the most sophisticated business lawyer cannot answer a seemingly simple question: whether, in the absence of an express agreement to the contrary, the manager of a Delaware limited liability company (LLC) owes traditional fiduciary duties to its members as a default matter? This was not always the case. Until recently, this question was settled—settled at least in the Delaware Court of Chancery. But in November 2012, the Delaware Supreme Court cast doubt on a long line of chancery court precedent in Gatz Properties v. Auriga Capital. Given the broad freedom of contract available under LLC law, it may be that default duties do not much matter. And, in any case, the uncertainty created by Gatz as to default duties is sure to be soon resolved through legislation. If so, then the lasting impact of Gatz is not on the substantive legal question. Rather, the lasting impact of Gatz is on Delaware law’s reputation for certainty and the use of dictum, a judicial practice key to fostering that reputation.

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. GATZ IN CONTEXT 4
   A. The Antecedent Debate over Fiduciary Waivers ....................... 5
   B. The Present Debate over Default Duties ............................... 7
   C. Gatz Properties v. Auriga Capital .................................. 11
      1. Chancery Court confirms Default Fiduciary Duties .............. 12
      2. Supreme Court repudiates the Chancery’s Dictum .......... 16

III. GATZ’S COMPROMISE ON PRECEDENT AND DICTUM 20
   A. The Supreme Court’s Novel Contractual Approach .................. 21
      1. Gaps in the LLC Agreement ......................................... 21
      2. The Supreme Court’s “Functional” Interpretation .............. 25
   B. The Supreme Court’s Newfound Disdain for Dictum ............... 28
      1. A Venerable Delaware Tradition .................................... 28
         a. Chancery Court Dictum ....................................... 29
         b. Supreme Court Dictum ......................................... 30
      2. Dictum’s Guidance, Regulatory and Responsive Functions ....... 33
   C. Compromise over Precedent and Dictum ................................ 39

IV. IMPLICATIONS OF GATZ 43
   A. Implications for LLC Agreements ..................................... 43
   B. Implications for Delaware ............................................. 47
      1. Amendment to the LLC Statute .................................... 47
      2. Lingering Harm to Reputation and Law-Making Process .......... 49

V. CONCLUSION 52
I. INTRODUCTION

Bizarrely, today even the most sophisticated business lawyer cannot answer a seemingly simple question: whether, in the absence of an express agreement to the contrary, the manager of a Delaware limited liability company (LLC) owes traditional fiduciary duties to its members as a default matter? Despite the LLC form’s ever growing importance,¹ and Delaware’s success in attracting LLCs to organize within its jurisdiction,² the answer to this question is still unknown—which is, to put it mildly, a bit surprising. Whether LLC managers owe fiduciary duties as a default matter is the type of question that goes to the very heart of LLC governance—to the very heart of how lawyers are to draft LLC agreements.

This was not always the case. Before November 2012, this question of what duties are owed as a default was a settled one—settled at least in the Delaware Court of Chancery. In a string of decisions, the chancery court had repeatedly and

¹ See generally Rodney D. Chrisman, LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004-2007 and How LLCs were Taxed for Tax Years 2002-2006, 15 FORDHAM J. CORP. & FIN. L. 459 (2010).
² See, e.g., Michelle M. Harner & Jamie Marincic, 54 ARIZ. L. REV. 879, 901 (2012) (finding that in a dataset of 150 LLCs in which one or more party is a public company over half were organized under and governed by Delaware law); Mohsen Manesh, Contractual Freedom under Delaware Alternative Entity Law, 37 J. CORP. L. 555, 598 n.236 (2012) (noting that all but one of the 85 publicly traded LLCs and limited partnerships in existence in 2011 are organized under Delaware law); Bruce H. Kobayashi & Larry E. Ribstein, Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies, 2011 U. ILL. L. REV. 91, 116 (2011) (finding that among closely held LLCs with 50 or more employees that form outside of their home state, more than 61% are organized under Delaware law); Jens Dammann & Matthias Schundeln, Where are Limited Liability Companies Formed? An Empirical Analysis, Univ. of Tex. Sch. of Law, Law and Economics Research Paper No. 126, June 28, 2010, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1633472 at 3 (finding that among closely held LLCs with 5000 or more employees that form outside of their home state, more than 95% are organized under Delaware law).
unequivocally ruled that, in the absence of an agreement to the contrary, an LLC manager owes members traditional fiduciary duties. But in November 2012, the Delaware Supreme Court cast doubt on this precedent in *Gatz Properties v. Auriga Capital.*

Sharp disagreements between Delaware’s supreme court and its inferior court of chancery are not new, even in the unincorporated alternative entity context. Indeed, this article is not about the underlying legal dispute reflected in *Gatz.* Others have already addressed that question.

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5 Before *Gatz,* perhaps the most high-profile disagreement between the Delaware chancery court and supreme court involved the legitimacy of so-called “substantive coercion” as a cognizable threat to justify use of a poison pill under the *Unocal* standard. See Air Prods. & Chemical, Inc. v. Airgas, Inc., 16, A.3d 48, 57-58 (Del. Ch. 2011).

6 See infra Part II.A.

managers of an LLC should owe fiduciary duties as a default is ultimately a normative question, sometimes couched in economic\(^8\) or technical statutory arguments.\(^9\)

Rather, this article is about the problematic compromise reflected in *Gatz*. Seemingly unable to muster a consensus on the default duties question, the Delaware Supreme Court avoided internal divisions by instead attacking the chancery court’s consideration of the matter as “improvident and unnecessary” dictum.\(^10\) The problem with this compromise is that it undermines both the certainty of Delaware law as well as a judicial tool long used by Delaware courts to address uncertainty. By attacking the use of dictum, the supreme court attacked an important facet of Delaware’s lawmaking process—an established judicial practice vital to the state’s success in attracting corporate, and now LLC, charters.\(^11\)

Given the broad freedom of contract available under Delaware LLC law, it may be that default duties do not much

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\(^{8}\) See Steele, *Freedom of Contract and Default Contractual Duties*, supranote ___, at 236-42.

\(^{9}\) See Connaway & Tsolfias, *supra* note ___, at Part II.


\(^{11}\) See *infra* Part III.B.2.
And, in any case, the uncertainty created by Gatz as to default duties is sure to be soon resolved through legislation. If so, then the lasting impact of Gatz is not on the substantive legal question. Rather, the lasting impact of Gatz is on Delaware law’s reputation for certainty and the judicial practice key to fostering that reputation.

The remainder of this article proceeds in four parts. Part II sets the default duties debate in a broader context, describing the judicial precedent and legislative history leading up to the Gatz decision. Given this context, Part III then highlights the compromise made in Gatz with respect to doctrine and dictum. In particular, Part III will show that Gatz departs from the contractual language at issue, the supreme court’s own precedent as well as a rich Delaware tradition, in which its courts have long used dictum to serve important guidance, regulatory and responsiveness functions. Part IV then considers Gatz’s implications. In the near term, Gatz will likely prompt an amendment to Delaware’s LLC statute. Longer term, however, Gatz will have consequences that cannot be fixed by a simple legislative amendment. Part V briefly concludes.

II. GATZ IN CONTEXT

The fiduciary duty owed by those who exercise control to those who entrusted them with control has long been a bedrock of the law of business associations. It has been a bedrock in the law of both corporations and partnerships—the two entities of which the LLC is supposedly a hybrid. So, how did we even get to this point? How did we get to a situation in which it is

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now an open question whether fiduciary duties, once famously described as “unbending and inveterate,” apply to an LLC manager at all in the absence an express agreement imposing such obligations? To answer this question, one must understand Gatz’s historical antecedents.

A. The Antecedent Debate over Fiduciary Waivers

The legal question raised by Gatz has its roots, ironically, in an earlier Delaware Supreme Court decision. In 2002, the supreme court attempted to settle another then-nagging question involving unincorporated alternative entities. The question was this: to what extent could an LLC and its ancestral relative, a limited partnership (LP), contractually eliminate the fiduciary duties of its managers through the terms of its governing agreement?

At that time, Delaware’s LLC and LP statutes were unclear. The statutes simply provided that fiduciary duties “may be expanded or restricted” by the terms of an LLC or LP agreement. Nowhere did the statutes mention whether such duties may be waived altogether. But in a pair of decisions, the Delaware Chancery Court had suggested that the statutory “expanded or restricted” language permitted fiduciary duties to be wholly eliminated. These judicial pronouncements were

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mere dicta, however; no Delaware court had definitively ruled on the matter.

By 2002, the Delaware Supreme Court felt it necessary to confront what it viewed as the chancery court’s “dubious dictum.” And it did so in *Gotham Partners v. Hallwood Realty.* But because the matter was not squarely presented by the *Gotham Partners* litigation, the supreme court was forced to engage in its own dictum to reach the fiduciary waiver question:

In our view [the chancery court’s] dictum should not be ignored because it could be misinterpreted in future cases as a correct rule of law. Accordingly, in the interest of avoiding the perpetuation of a questionable statutory interpretation that could be relied upon adversely by courts, commentators and practitioners in the future, we are constrained to draw attention to the statutory language and the underlying general principle in our jurisprudence that scrupulous adherence to fiduciary duties is normally expected.

This judicial disagreement between the supreme court and court of chancery, waged in dictum, was ultimately resolved through legislative intervention. After the Delaware Supreme Court’s

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19 *Id.*
20 *Id.* (conceding that “it is not appropriate for us to express an advisory opinion on a matter not before us”)
21 *Id.*
**Gotham Partners** decision, the Delaware General Assembly amended the state’s LLC and LP statutes to make clear that fiduciary duties may be contractually waived altogether—“expanded, restricted or eliminated”—by the terms of an LP or LLC agreement.23 The question was settled. The chancery court’s statutory construction, originally espoused in dictum, prevailed over the supreme court’s construction. Although it is still controversial policy,24 today, no one doubts that, as a legal matter, LLCs and LPs can wholly eliminate the fiduciary duties of managers by contractual agreement.25

### B. The Present Debate over Default Duties

By settling the judicial debate over outright fiduciary waivers, the Delaware legislature inadvertently raised another question. This question is the one that vexes LLC law today: to what extent are managers bound by fiduciary duties in the absence of an express agreement imposing such duties? Put differently, to what extent do LLC managers owe fiduciary duties as a default matter? The debate over this question has the familiar hallmarks of yesteryear’s judicial disagreement over fiduciary waivers. In the absence of clear legislative intent, it

23 **DEL CODE ANN.** tit. 6, §§ 17-1101(d) (2005) (governing LPs); 18-1101(c) (governing LLCs).

24 See Manesh, *Contractual Freedom*, supra note ___, at 562-63 (summarizing the traditionalist arguments against permitting contractual fiduciary waivers).

has pitted the Delaware Supreme Court against the Delaware Court of Chancery.

With respect to the Delaware LLC statute, although the statute now clearly allows for fiduciary duties to be contractually eliminated, it never confirms that fiduciary duties are owed in the absence of a contractual waiver.\(^{26}\) Instead, the statute simply provides that “to the extent [one] has duties (including fiduciary duties)... [such] duties ... may be expanded, restricted or eliminated” by the terms of an LLC agreement.”\(^{27}\) But the statute never affirms the existence of fiduciary duties to begin with. In this respect, the Delaware legislature seems to have explicitly deferred an important policy decision to the Delaware judiciary to determine the default duties owed by LLC managers and members.\(^{28}\)

The Delaware LLC statute was modeled on the state’s LP statute; in fact, much of the architecture and wording of the two statutes are identical.\(^{29}\) Like its LLC statute, Delaware’s LP statute provides that fiduciary duties may be contractually waived or modified, even though it never affirmatively provides

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26 See Auriga, 40 A.3d at 849 (“The Delaware LLC Act does not plainly state that the traditional fiduciary duties of loyalty and care apply by default as to managers or members of a limited liability company.”); see also ROBERT L. SYMONDS, JR. & MATTHEW J. O'TOOLE, DELAWARE LIMITED LIABILITY COMPANIES § 9.04[B][3] (2012 supp.).
27 Del. Code Ann. tit. 6, § 18-1101(c).
28 See Kelly v. Blum, No. 4516-VCP, 2010 WL 629850, at *10 (Del. Ch. Feb. 24, 2010) (Parsons, V.C.) (observing that the Delaware LLC act “does not specify a statutory default provision...; rather, it implies that some default fiduciary duties may exist ‘at law or in equity,’ inviting Delaware courts to make an important policy decision and determine the default level of those duties”); see also SYMONDS & O'TOOLE, supra note ___ § 9.04[B][3] (“The statute leaves such matters [i.e. fiduciary duties] to the development in the Delaware case law.”); cf. Lawrence A. Hamermesh, The Policy Foundations of Delaware Corporate Law, 106 Colum. L. Rev. 1749, 1776-82 (2006) (describing, in the corporate law context, the Delaware legislature’s frequent deference to the judiciary for addressing significant issues).
that fiduciary duties are owed as a default matter. Given the
historical roots of the LP form in the law of general
partnerships, however, there has never been a serious question
whether the general partner of an LP owes fiduciary duties as a
default in the absence of a contractual waiver or modification.

Because Delaware’s LLC statute was based on its LP statute
and employs nearly identical language authorizing fiduciary
waivers, the court of chancery, academics and practitioners had long assumed that, like the general partner of an LP, managers and controlling members of an LLC owe fiduciary
duties as a default matter. In fact, this principle was never even

31 See Connaway & Tsolias, supra note __, at Part II.B; see also Del. Code Ann. tit.
6, §§ 17-1105 (“In any case not provided for in this chapter, the Delaware Uniform Partnership Law ... and the rules of law and equity, including the Law Merchant, shall govern.”).
32 See, e.g., Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A.2d 160,
170 (Del. 2002) (“As the Vice Chancellor noted at summary judgment, a general partner owes the traditional fiduciary duties of loyalty and care to the limited partnership and its partners.”). Moreover, in the case of a corporate general partner, the Delaware Chancery Court has long held that those entities and individuals who exercise control over the general partner also owe some fiduciary duties to the limited partners, although this latter principle is controversial and has not been endorsed by the Delaware Supreme Court. See Feeley v. NHAOCG, 2012 WL 5949209, *14-*17 (Del. Ch. Nov. 28, 2012).
33 See supra note __.
34 See, e.g., Manesh, Contractual Freedom, supra note __, at 560; Larry E. Ribstein,
The Uncorporation and Corporate Indeterminacy, 2009 U. Ill. L. Rev. 131, 146, 150.
35 See, e.g., Doug Batey, “Delaware Supreme Court Introduces Uncertainty about
Fiduciary Duties of LLC Managers,” LLC Law Monitor Blog (Nov. 21, 2012),
http://www.illawmonitor.com/2012/11/articles/fiduciary-duties/delaware-supreme-
seriously questioned until a 2009 article by the Delaware chief justice.\textsuperscript{36} Writing in an extrajudicial capacity, Chief Justice Myron Steele argued that the strong legislative policy favoring the freedom of contract in matters of LLC governance\textsuperscript{37} was inconsistent with the notion of default fiduciary duties if an LLC is, as the statute suggests, purely a contractual relationship.\textsuperscript{38}

This novel assertion caused a buzz; there was even a symposium to debate the question.\textsuperscript{39} What was lacking, however, was a definitive judicial pronouncement. To be sure, the Delaware Chancery Court had, through the course of deciding LLC cases, developed a predictable framework for applying fiduciary duties:

Where the parties have clearly supplanted default [fiduciary duties] in full, we give effect to the parties' contract choice. Where the parties have clearly supplanted default [fiduciary duties] in part, we give effect to their contract choice. But, where the core default fiduciary duties have not been supplanted by contract, they exist [as a default]....\textsuperscript{40}

And using this framework, a number of Delaware chancery court decisions had applied traditional fiduciary duties as the default duties in LLCs, in the absence of a contractual modification or

\textsuperscript{36} See generally Steele, \textit{Freedom of Contract and Default Contractual Duties, supra} note ___.

\textsuperscript{37} \textsc{Del. Code Ann.} tit. 6, § 18-1101(b).

\textsuperscript{38} See generally Steele, \textit{Freedom of Contract and Default Contractual Duties, supra} note ___, at 233-36.


waiver. But this framework presupposed fiduciary duties are owed as a default matter. Neither the chancery nor supreme court had ever questioned this assumption. Given the chief justice’s provocation, the matter seemed ripe for judicial consideration. And in Gatz, both the chancery court, per Chancellor Strine, and the supreme court found an occasion to take up the question.

C. Gatz Properties v. Auriga Capital

Gatz presented particularly egregious facts, so it is perhaps unsurprising that Chancellor Strine used the case as an opportunity to explicitly address the question raised by the Delaware chief justice. The defendant in Gatz had sought to eliminate the minority investors of an LLC of which the defendant was the sole manager and controlling member. To accomplish this goal, the defendant-manager caused the LLC to undertake a squeeze-out merger under false pretenses, leaving the manager as the LLC’s sole owner and the plaintiffs, the minority members of the LLC, with virtually nothing to show for their investment.

The minority members made both fiduciary and contractual claims challenging the manager’s actions. As to the former, the minority members alleged that the manager had breached his fiduciary duties in both the squeeze-out merger and his actions leading up to the transaction. As to the latter, the minority members alleged that the transaction had breached the manager’s contractual obligation under the parties’ LLC

41 See supra note ___.
42 Auriga, 40 A.3d at 841-44.
43 Id. at 859-73.
44 Id. at 848.
45 Id.
agreement, the express terms of which prohibited the manager from entering into any transactions with the LLC “on terms and conditions ... less favorable ... than the terms and conditions of similar agreements which could be entered into with arms-length third parties.”

1. Chancery Court confirms Default Fiduciary Duties

To consider the minority members’ claims, Chancellor Strine sensibly began by asking what legal duties the manager owed the minority members. Because the LLC agreement did not explicitly eliminate fiduciary duties, the chancellor addressed whether such duties are owed as a default in the absence of a contractual waiver.

In his trademark discursive style, with “thoroughness, scholarship, wit and linguistic dexterity,” the chancellor explained why fiduciary duties applied to the manager as a default matter. Conceding that Delaware’s LLC statute is ultimately silent on the question of default duties, the chancellor

46 The relevant LLC agreement provision provided in full that

Neither the Manager nor any other Member shall be entitled to cause the Company to 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 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).

Auriga, 40 A.3d at 857.

47 Id. at 849.


49 Auriga, 40 A.3d at 849-56.
argued that applying fiduciary duties as the default was nonetheless consistent with the intent of the Delaware legislature.\(^50\) He observed that the statute explicitly invokes equitable principles as a backdrop\(^51\) and that, under traditional equitable principles, “[i]t seems obvious” that an LLC manager fits the definition of a fiduciary.\(^52\) Moreover, he noted, the 2004 legislative amendments following \textit{Gotham Partners}, which expressly permitted the elimination of fiduciary duties.\(^53\) These amendments only make sense, the chancellor reasoned, if the legislature believed that fiduciary duties existed as a default matter; otherwise, there would be nothing that would need eliminating.\(^54\) Perhaps more important than the statutory text and legislative history, however, the chancellor cited a separate policy consideration: the substantial reliance and settled expectations that had developed around the statutory language, legislative history and judicial precedent applying default fiduciary duties.\(^55\) In light of these considerations, “a judicial eradication of [default fiduciary duties] could tend to erode our state’s credibility with investors.”\(^56\) Taken together, the chancellor concluded as a matter of statutory construction that the manager of a Delaware LLC owes traditional fiduciary  

\(^{50}\) \textit{Id.} at 849-52.  
\(^{51}\) \textit{See} \textit{Del. Code Ann. tit. 6, §§ 18-1104 (“In any case not provided for in this chapter, the rules of law and equity…shall govern.”)}  
\(^{52}\) \textit{See Auriga}, 40 A.3d at 850. Specifically, the court reasoned that “a fiduciary relationship is a situation where on person reposes special trust in and reliance on the judgment of another…. An LLC manager, vested with discretionary power to manage the business of the LLC, easily fits th[is] definition….” \textit{Id.} at 850-51.  
\(^{53}\) \textit{See supra note __.}  
\(^{54}\) \textit{Auriga}, 40 A.3d at 851-52.  
\(^{55}\) \textit{Id.} at 853-56.  
\(^{56}\) \textit{Id.} at 854.
duties as a default matter in the absence of a contractual waiver or modification.\textsuperscript{57}

With this holding, the chancellor then turned to examine whether the parties’ LLC agreement contractually modified or displaced the manager’s default obligations. To the contrary, the chancellor found that the LLC agreement reaffirmed, rather than restricted, the manager’s fiduciary duties.\textsuperscript{58} By explicitly prohibiting the manager from any transactions with the LLC “on terms and conditions ... less favorable” than what would be negotiated with “arms-length third parties,”\textsuperscript{59} the LLC agreement imposed on the manager a contractual obligation consistent with the fiduciary standard of entire fairness.\textsuperscript{60} Entire fairness is the equitable standard by which Delaware law measures the fiduciary duty of loyalty where a fiduciary engages in a self-dealing transaction.\textsuperscript{61} The test entails two prongs: procedural fairness and substantive fairness.\textsuperscript{62} Procedural fairness requires fair dealing by the fiduciary. It looks at “when the transaction was timed, how it was initiated, structured, negotiated, disclosed ..., and how the approvals [of the relevant decision-makers] were obtained.”\textsuperscript{63} By contrast, substantive fairness, commonly known as “price” fairness,\textsuperscript{64} “relates to the economic and financial considerations of the conflicted transaction.”\textsuperscript{65} The “arms-length” provision, the chancellor observed, contractually restated the fiduciary obligation of

\textsuperscript{57} Id. at 856.
\textsuperscript{58} Id. at 856-57.
\textsuperscript{59} See supra note ___.
\textsuperscript{60} Auriga, 40 A.3d at 856-57.
\textsuperscript{61} Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).
\textsuperscript{62} See id. at 711.
\textsuperscript{63} Id.
\textsuperscript{64} Id.
\textsuperscript{65} Id.
Thus, the chancellor concluded that the LLC agreement, rather than modifying or displacing fiduciary duties, was consistent with the manager’s default obligations.\textsuperscript{67}

Against this backdrop, the chancellor held the defendant-manager had breached both his fiduciary and contractual duties by intentionally pursuing in bad faith a course of conduct designed to unfairly squeeze-out the LLC’s minority members at an artificially depressed price, well below what would have been paid in a transaction with any “arms-length third-parties.”\textsuperscript{68} There were, the chancellor found, ample facts to support this conclusion. When the manager knew for several years that the LLC’s sole cash-producing asset, a lease of real property, would not be renewed, he did nothing to find a new tenant or explore strategic alternatives.\textsuperscript{69} Rather, he simply waited for the lease to expire and used the pending expiration as justification to withhold distributions to the LLC’s minority members.\textsuperscript{70} When a credible third party emerged and expressed repeated interest in purchasing the LLC’s business, the manager refused to cooperate with the would-be buyer or to provide it with basic due diligence materials.\textsuperscript{71} Then, when the manager approached the minority members with an offer to purchase their membership units, the manager misrepresented the third-party’s interest in acquiring the LLC’s business.\textsuperscript{72} To further his deception, the manager trumpeted a depressed valuation of the LLC computed based on manipulated information that the manager had

\textsuperscript{66} See Auriga, 40 A.3d at 857.
\textsuperscript{67} See id. at 856-57.
\textsuperscript{68} See id. at 859.
\textsuperscript{69} See id. at 860-63.
\textsuperscript{70} See id.
\textsuperscript{71} See Auriga, 40 A.3d at 863-66.
\textsuperscript{72} See id. at 866-68.
furnished to an outside appraiser.\textsuperscript{73} And when the LLC’s cash flow eventually dried up, because the lease expired without renewal as expected, the manager caused the LLC to engage in a hurried, “sham” auction, “well-designed to deter any third-party buyer.”\textsuperscript{74} Unsurprisingly, the manager was the sole bidder at the auction. He acquired the LLC at a “fire-sale price,” cashing out the minority members at a fraction of what the members had originally invested.\textsuperscript{75} Given these facts, the chancellor held the manager had breached both his default fiduciary duties as well as his bargained for contractual obligations.

Practitioners immediately took note of the chancellor’s \textit{Gatz} opinion and understood its significance in the broader LLC context.\textsuperscript{76} By providing a “comprehensive treatment ... of statutory history and construction of [the relevant LLC statutory provisions]” and a “comprehensive review of Delaware case law on the issue,”\textsuperscript{77} Chancellor Strine’s \textit{Gatz} opinion directly answered the question raised by the chief justice.

\textbf{2. Supreme Court repudiates the Chancery’s Dictum}

On appeal, Delaware Supreme Court affirmed chancellor’s judgment.\textsuperscript{78} But in a biting, unsigned \textit{per curiam} opinion, the

\begin{itemize}
\item \textsuperscript{73} See \textit{id.} at 868-69.
\item \textsuperscript{74} See \textit{id.} at 859, 870-73
\item \textsuperscript{75} See \textit{id.} at 872-73.
\item \textsuperscript{77} Pileggi, \textit{supra} note \textsuperscript{76}.
\end{itemize}
supreme court also repudiated the chancellor’s reasoning, in particular his consideration of the default duties question.\textsuperscript{79} Instead, the supreme court affirmed the chancery court’s judgment “solely on contractual grounds,”\textsuperscript{80} focusing on the “arms-length” provision of the LLC agreement.\textsuperscript{81} Like the chancery court, the supreme court interpreted the “arms-length” provision to impose a fiduciary standard of fairness\textsuperscript{82} and found that the manager’s forced squeeze-out merger had breached this contractually imposed standard.\textsuperscript{83}

Because the dispute could be resolved solely by reference to the “arms-length” provision, however, the supreme court found it unnecessary to reach the question of whether, in addition to this fiduciary standard imposed by contract, the manager owed the full range of traditional fiduciary duties as a default matter.\textsuperscript{84} Whether the manager owed default fiduciary duties was irrelevant; the express provisions of the LLC agreement already addressed the question.\textsuperscript{85} Accordingly, the Delaware Supreme Court renounced the chancellor’s consideration of the default duties question “as dictum without any precedential value.”\textsuperscript{86}

Ironically, however, the supreme court went on. Even though it found it unnecessary to take up the default duties question, the court “pause[d] to comment”—that is, engage in its own

\textsuperscript{79} Id. at *9.
\textsuperscript{80} Id. at *8.
\textsuperscript{81} Id. at *5-*7.
\textsuperscript{82} See id. at *6.
\textsuperscript{83} See Gatz, 2012 WL 5425227, at *6-*7.
\textsuperscript{84} Id. at *9.
\textsuperscript{85} Id.
\textsuperscript{86} Id.
dictum—to address the chancellor’s conclusion on the matter.87 “We feel compelled to address [the chancery court’s] dictum,” the court explained, citing to its legislatively rejected Gotham Partners decision, “because it could be misinterpreted in future cases as a correct rule of law, when in fact the question remains open.”88

Then, in unusually sharp terms,89 the court excoriated the chancellor:90 “[I]t was improvident and unnecessary to reach out and decide, sua sponte, the default fiduciary issue....”91 It was “unnecessary,” because the “arms-length” provision of the LLC agreement governed the parties’ dispute, and no litigant asked the court to decide the default duties question.92 It was, moreover, “improvident” for three reasons. First, the chancellor wrongly implied that the reliance and settled expectations of Delaware LLC investors and practitioners should somehow constrain the supreme court in its construction of the state’s

87 Id.
88 Id.
90 The unusually sharp tone of the supreme court’s per curiam opinion may, in part, be attributable to personal differences—reportedly “simmering tension”—between Chancellor Strine and Chief Justice Steele. See Lattman, supra note __. Indeed, at oral arguments before the supreme court, Chief Justice Steele seemed to mock the chancellor in his questioning of the defendant’s counsel: “Why did [the chancellor] go into this whole diatribe, for lack of a better word, of about how ignorant people are who think other than he does about whether the default position is that fiduciary duties apply or don’t apply?”93 Gatz Props., LLC v. Auriga Cap. Corp., Corp., Oral Arguments, minute 18 (Del. Sept. 19, 2012), available at http://courts.delaware.gov/supreme/audioargs.stm.
92 Id. at *10.
LLC statute. Second, as to the merits of the issue, the supreme court equivocated that “reasonable minds could differ” on the default duties question. By providing “to the extent that, at law or in equity a ... manager ... has duties (including fiduciary duties)” in the statute, the Delaware legislature was “consciously ambiguous” on the matter. Finally, the supreme court explained, the “[chancellor’s] excursus on [the default duties] issue strayed beyond the proper purview and function of a judicial opinion,” which is to “resolve the issues that the parties present in a clear and concise manner” rather than “propagate [the judge’s] individual world views on issues not presented.”

The Delaware Supreme Court’s ruling in Gatz was received with much surprise in both practitioner and academic quarters. While the supreme court did not expressly overturn the chancellor’s conclusion that traditional fiduciary duties are owed in the absence of a contractual waiver or modification, it

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93 Id.
94 Id.
95 Id.
96 Id.
97 Id.
98 See Batey, “Delaware Supreme Court Introduces Uncertainty,” supra note ___ (describing the supreme court’s decision as “confounding the conventional wisdom” because “[m]ost Delaware corporate lawyers ha[d] assumed that LLC managers are subject to fiduciary duties unless limited by the LLC agreement”); Norman & Mercer, supra note ___ (describing the supreme court’s decision as “undo[ing] what many practitioners had expected to be a durable principle”); Gibson Dunn & Crutcher, LLP, “Do LLC Managers and Controlling Members have Default Fiduciary Duties? Maybe.” (Nov. 12, 2012) (describing Gatz as “thrust[ing] back into the realm of uncertainty” a seemingly settled matter), at http://www.gibsondunn.com/publications/pages/DoLLCManagers-ControllingMembers-HaveDefaultFiduciaryDuties.aspx.
raised serious doubts about this seemingly settled matter. By renouncing the chancellor’s analysis as nonbinding dictum and warning that it should not be “misinterpreted as a correct rule of law” in future cases, by asserting that central provisions of the Delaware LLC statute are “ambiguous” and that “reasonable minds could differ,” the supreme court made clear that going forward, contract drafters and parties to LLC agreements could no longer take default fiduciary duties for granted.

III. GATZ’S COMPROMISE ON PRECEDENT AND DICTUM

Gatz is not the first time that the Delaware Supreme Court has publicly disagreed with the chancery court in its construction of the state’s alternative entity statutes. After all, before Gatz there was Gotham Partners, an earlier dispute waged in dictum before being settled through legislation in the chancery court’s favor.

But upon closer inspection, Gatz is a particularly peculiar opinion—peculiar in its strained interpretation of the relevant LLC agreement, its critical treatment of dictum, and its ultimate failure to resolve the underlying default duties question. With respect to the LLC agreement, the supreme court adopted an unlikely interpretation of the agreement’s express terms, one unsupported by the court’s own precedent. Only by doing so was the court able to purportedly resolve the parties’ dispute “solely on contractual grounds” and conclude that the chancellor’s consideration of the default duties question to be “unnecessary” dictum. Even if one accepts this interpretation, however, with respect to court’s treatment of dictum, its newfound disdain for dictum as “improvident” and even improper contradicts a venerable Delaware tradition. And

101 See supra Part II.A.
despite all this, with respect to underlying default duties question, the supreme court declined to provide any resolution, notwithstanding the court’s historic willingness to wade into dictum to provide guidance on such questions. Instead, the court unsettled a settled principle of Delaware law and then left uncertainty to fester.

So, what accounts for these peculiar machinations? The below analysis suggests that Gatz was a troubled compromise, masking dissenting opinions among the Delaware justices on a divisive question.

**A. The Supreme Court’s Novel Contractual Approach**

By purporting to resolve the parties’ dispute “solely on contractual grounds,” the supreme court was able to dismiss the chancellor’s consideration of the default duties question as “unnecessary” dictum. But to reach this conclusion required the supreme court to adopt a strained interpretation of the parties’ contract and its own precedent.

**1. Gaps in the LLC Agreement**

The only relevant provision in the LLC agreement at issue in Gatz, and the provision on which the supreme court purported to resolve the case, was the “arms-length” provision, which provided simply that the manager shall not enter into any transactions with the LLC “on terms and conditions ... less favorable” to the LLC than what would be entered into with “arms-length third parties.” The “arms-length” provision

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103 Id. at *10 (“[T]he ... LLC Agreement explicitly and specifically addressed the ‘fiduciary duty issue’ in Section 15, which controls this dispute.”).
104 See supra note __.
inarguably provides a contractual standard by which to measure the terms and conditions of the manager’s forced squeeze-out merger. But the “arms-length” provision also leaves unanswered a number of questions raised by the parties’ dispute.

Consider, first, the following question: what (if any) obligation did the manager owe in circumstances other than those involving a self-dealing transaction? Although the “arms-length” provision provided a contractual standard by which to measure the terms of the squeeze-out merger, the minority members’ complaint went beyond the fairness of the terms of that specific transaction. Under minority members’ complaint, the manager had engaged in several years of “protracted ... self-interested conduct conceived and implemented in bad faith for the purpose of eliminating the Minority Members.”\(^\text{105}\) Thus, the minority members alleged the manager had breached his fiduciary duty of loyalty by engaging in bad faith conduct long before the squeeze-out merger. He had withheld distributions, misled the minority members and refused to consider any strategic alternatives for the LLC.\(^\text{106}\) The squeeze-out merger was, under the minority members’ allegation, merely the culmination of fiduciary infidelity that had transpired for many years.\(^\text{107}\) Even if the transaction itself had complied with the manager’s contractual and fiduciary obligations, the minority members alleged the manager had breached his fiduciary duty of good faith through past actions that were purposefully inimical to the interests of the LLC and its minority members.

\(^{105}\) See Auriga, 40 A.3d at 848.


\(^{107}\) Id. at para. 54 (“In sum, the Auction and squeeze out were ... simply the culmination of a plan to oust the minority and capture the upside value of the property [leased by the LLC] for the Gatz family.”)
Like Chancellor Strine, the supreme court found that the manager’s self-interested, bad faith conduct during the years prior to the squeeze-out merger breached the manager’s duty owed to the minority members. But the manager’s conduct during this period did not breach any express obligation under the LLC agreement. The “arms-length” provision, in particular, was inapplicable; it applied only to the fairness of the “terms and conditions” of the squeeze-out merger. If the manager’s self-interested, bad faith conduct during the years preceding the transaction had breached any obligation, it was only because, as the chancellor found, the manager owed fiduciary duties of loyalty and good faith as a default matter. It could not be because, as the supreme court purported, he had breached any express contractual obligation.

Consider, next, the question of the manager’s duties in the specific context of a self-dealing transaction like the squeeze-out merger. What (if any) additional obligations, beyond what is express in the LLC agreement, did the manager owe in a conflicted context? To be sure, as a contractual matter, the manager owed a duty to refrain from any self-dealing transactions “on terms and conditions ... less favorable” to the LLC than what would be agreed to with any “arms-length third parties.” But what about the manager’s failure to disclose certain material information, failure to condition the squeeze-

108 See Auriga, 40 A.3d at 860-63.
110 With respect to the period of years before the squeeze-out merger, the chancellor observed that the defendant's conduct was “governed by traditional fiduciary duties of loyalty and care because the LLC agreement does not alter them.” Auriga, 40 A.3d at 858.
111 See Auriga, 40 A.3d at 858 (reasoning that the “arms-length” provision applies only to the fairness of a self-dealing transaction and not the “rest of [the defendant’s] conduct giving rise to this dispute”).
112 See supra note ____.
out merger on the approval of a majority of the minority members, and decision to expedite the transaction, precluding any third-party offer? Full disclosure, majority-of-minority approval and the timing of the transaction are all factors that Delaware courts consider under the procedural fairness prong of the entire fairness standard.

But, as noted above, the LLC agreement addressed only the fairness of the “terms and conditions” of the transaction; it said nothing about a fair process. Like Chancellor Strine, the supreme court concluded that the manager owed an obligation to provide a fair process. But an obligation of procedural fairness is not imposed by the parties’ LLC agreement. Such obligation makes sense only if, as the chancellor found, the manager owed a fiduciary obligation of fair dealing as a default matter.

Consider, finally, the question of how the burden of proof was allocated as between the plaintiffs and defendant-manager. Assuming that the manager owed a duty of fair dealing and fair price, who bears the burden of proof to prove fairness (or unfairness)? In a traditional breach of contract claim, the plaintiff (the alleged victim of breach) bears the burden of persuasion. And the LLC agreement in Gatz—and the “arm-length” provision in particular—did not expressly alter this

113 See Auriga, 40 A.3d at 867-75 (summarizing the court’s factual findings as to the auction and squeeze-out merger).


115 See supra note ___.

116 See Auriga, 40 A.3d at 857-58.


118 See Gatz, 2012 WL 5425227, *6 (“[T]he language of Section 15 [the “arms-length” provision] speaks only in terms of fair price.”); accord Auriga, 40 A.3d at 857-58 (interpreting the language of the “arms-length” provision to “distill” the entire fairness doctrine into simply the obligation of substantive fairness).

Like Chancellor Strine, however, the supreme court presumed the manager had the burden of persuasion, though nothing in the express language of the LLC agreement justified this presumption. Again, allocating to the manager the burden of persuasion makes sense only if, as the chancellor found, the manager owed a fiduciary obligation of entire fairness as a default matter. Burden-shifting does not make sense, however, “solely on contractual grounds” as the supreme court purported.

2. The Supreme Court’s “Functional” Interpretation

Because the LLC agreement—and the “arms-length” provision in particular—did not provide answers to the above questions, to resolve the parties’ dispute required an initial determination of what duties the defendant-manager owed as a default matter. The chancellor in Gatz squarely addressed this question. By contrast, the supreme court finessed the issue by purporting to adopt a novel “functional” interpretation of the LLC agreement, interpreting the “arms-length” provision broadly to impose a fiduciary obligation of entire fairness—that is, both fair price and fair process—as a contractual matter.

To justify this “functional” interpretation, the court reasoned that “[t]here is no requirement that an LLC agreement use

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120 See supra note ___.
121 See Auriga, 40 A.3d at 858 (“Gatz bears the burden to show that he paid a fair price....”).
122 Gatz, 2012 WL 5425227, *6 (“[T]he burden of establishing the fairness of the transaction fell upon Gatz.”).
123 See Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983) (explaining that the fiduciary bears the burden to show fairness).
125 See id. at *5
126 See id. at *5 n.19 (“We interpret th[e] contractual obligation [under the ‘arms-length’ provision] as the contracted-for functional equivalent of entire fairness.”).
magic words, such as ‘entire fairness’ or ‘fiduciary duties’” to contractually impose fiduciary standards.127 “Viewed functionally, the [‘arms-length’ provision] is the contractual equivalent of the entire fairness standard.”128 Thus, the supreme court was able to hold that the squeeze-out merger, as well as the manager’s self-interested, bad faith conduct during the years prior to the transaction, breached the manager’s contractually imposed fiduciary obligation of entire fairness owed to the plaintiffs.129

But, as noted above, entire fairness requires both fair price and fair process,130 and the “arms-length” provision said nothing about the latter. The provision simply required that the “terms and conditions” of any self-dealing transaction be no “less favorable” to the LLC than what would be agreed to with any “arms-length third parties.”131 The fairness of the process that leads to such “terms and conditions” is not addressed by the express language of the LLC agreement.132 Unless it is required as a default matter, as the chancellor found, procedural fairness is simply irrelevant.133

Nonetheless, to support its “functional” interpretation, the supreme court cited to Gotham Partners.134 The court reasoned that the “arms-length” provision was “substantially identical” to contractual language the court had interpreted in that earlier

127 Id.
128 Id.
129 Id.*6-47
130 See supra notes ___-___ and accompanying text.
131 See supra note __.
132 See supra note __.
133 Fair process is certainly not required by the implied covenant of good faith. See Lonergan v. EPE Holdings, LLC, 5 A.3d 1008, 1016-21 (Del. Ch. 2010) (holding that the implied covenant cannot impose a fair process obligation like that associated with entire fairness where the LP agreement expressly permits self-dealing transactions approved by an alternative “special approval” process).
decision to require both fair price and fair process. The contractual language at issue in *Gotham Partners*, however, specifically and separately addressed both fair price and fair process. The “arms-length” provision, by contrast, addressed only the former; it was silent as to the latter. Thus, the court’s assertion that the “arms-length” provision is “substantially identical” to the language the court interpreted in *Gotham Partners* is simply mistaken. If anything, the absence of express contractual language requiring fair process, as was presented in *Gotham Partners*, undercuts the supreme court’s interpretation of the *Gatz* LLC agreement to require entire fairness.

Perhaps recognizing this weakness in its reasoning, the court conceded that the “arms-length” provision “speaks only in terms of fair price,” but that it was nonetheless proper to inquire, as the chancery court did, into procedural fairness, “because the extent to which the process leading to the self-dealing either replicated or deviated from the behavior one would expect in an arms-length deal bears importantly on the [fair] price determination.” For Chancellor Strine to apply the fair process facet of entire fairness makes perfect sense in a world where entire fairness is the default obligation unwaived by the LLC agreement. But the obligation of fair process cannot be justified, as the supreme court did, “solely” on the “arms-length”

135 *Id.*

136 See *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 166-67 (Del. 2002). Specifically, Section 7.05 of the LP agreement at issue in *Gotham Partners* required any self-dealing transaction to be “substantially equivalent to terms obtainable … from a comparable unaffiliated third party,” which the supreme court held to impose a contractual standard akin to price fairness. *Id.* Section 7.10(a) separately required that any self-dealing transaction to be approved by an independent audit committee, which the supreme court held to impose a contractual standard akin to fair dealing. *Id.*


138 *Id.* (quoting *Auriga*, 40 A.3d at 857).
provision, which required only fair “terms and conditions.” For a court that has long insisted that contractual language be interpreted in accordance with its “plain meaning,” the Delaware Supreme Court’s so-called “functional” interpretation of the parties’ agreement—requiring a fair process where the contract speaks only to “terms and conditions”—appears to be a marked departure from its own precedent.

B. The Supreme Court’s Newfound Disdain for Dictum

Even if one accepts the supreme court’s problematic “functional” interpretation of the parties’ LLC agreement, it is still more difficult to understand the supreme court’s harsh criticism of the chancellor’s use of dictum. Because in Delaware it is and has long been standard judicial practice to “stray[] beyond ... the issues that the parties present[ed].” Indeed, the liberal use of dictum to address matters unnecessary to the resolution of a litigation has been widely praised as a strength of Delaware law—a vital reason for the state’s success in attracting corporate, and now LLC, charters.

1. A Venerable Delaware Tradition

Dictum is a staple of Delaware law. Both the supreme court and court of the chancery have long accepted—even embraced—the use of dictum to resolve legal uncertainty, instill “best practices” and update the law to ensure it is current and responsive.

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139 See supra note ___.
140 See, e.g., BLGH Holdings LLC v. enXco LFG Holding, LLC, 41 A.3d 410, 414 (Del. 2012) (Where ... the plain language of a contract is unambiguous i.e., fairly or reasonably susceptible to only one interpretation, we construe the contract in accordance with that plain meaning and will not resort to extrinsic evidence to determine the parties’ intentions.
a. Chancery Court Dictum

At the chancery, In re Caremark is likely the most famous example of judicial dictum. In reviewing the fairness of a proposed settlement agreement to which no party objected, then Chancellor Allen took the opportunity to reformulate the oversight responsibilities of corporate directors to reflect the growing severity of corporate criminal sanctions imposed under new federal regulations. In doing so, the chancellor implicitly overturned an increasingly antiquated supreme court precedent. Caremark became, literally, the textbook articulation of a director’s oversight obligation. And some 20 years later, the Delaware Supreme Court would ultimately adopt Caremark’s dictum, in a decision ironically endorsed by the same five justices that would later denounce dictum as “improvident and unnecessary.”

Caremark is perhaps the most famous example of chancery court dictum; but it also typifies the court’s practice. Recall the chancery court dicta that spurred the supreme court’s ruling in Gotham Partners. For a more recent example, consider Smurfit-Stone, in which Vice Chancellor Parsons attempted to clarify a “perennial” question among transactional lawyers:

143 See id. at 967-70.
144 See id. at 969-70 (questioning the continued validity of Graham v. Allis-Chalmers Mfg. Co. 188 A.2d 125 (Del. 1963)).
147 See supra Part II.A.
What is the precise mix of consideration—cash versus stock of an acquirer—that will trigger so-called Revlon duties for the directors of a target corporation? The applicability of Revlon scrutiny to sale transactions in which the shareholders of the target receive mixed consideration is a matter that the Delaware Supreme Court has left unaddressed since a 1995 decision.150 While the vice chancellor conceded in Smurfit-Stone that the issue was irrelevant to the motion before him,151 the vice chancellor observed that an even 50-50 mix of cash and stock would trigger Revlon duties.152 This observation was dictum, unnecessary to the vice chancellor’s ultimate holding; however, practitioners immediately took note of the Smurfit-Stone opinion as providing important guidance on the long unsettled Revlon question.153

b. Supreme Court Dictum

While dictum abounds in the Delaware Court of Chancery, it is also a staple of Delaware Supreme Court jurisprudence.154

151 See Smurfit-Stone, 2011 WL 2028076, at *11 (conceding that “result would be the same” regardless of whether the challenged transaction is scrutinized under Revlon or the business judgment rule).
152 Id. at *11-*16.
Perhaps the most notable supreme court example is *Weinberger v. UOP*, the case most closely associated with the court’s articulation of entire fairness in the squeeze-out context.\(^{155}\) Counterfactually, the supreme court observed in its “famous” footnote 7 that “the result [of the case] could have been entirely different if [the defendant] had appointed an independent negotiating committee of its outside directors to deal with [its’ controlling shareholder] at arm’s length.”\(^ {156}\) Unsurprisingly, the use of independent committees has become standard practice since this footnoted observation.\(^ {157}\)

And *Weinberger* is not an isolated instance of the supreme court’s purposeful use of dictum. Consider, more recently, the *Disney* decision\(^ {158}\)—an opinion replete with dictum and again endorsed by the same five justices that would later decry dictum in *Gatz*. In *Disney*, the supreme court provided a lengthy—and what it recognized was unnecessary\(^ {158}\)—elaboration of the fiduciary good faith obligation because it “is not a well-developed area of our corporate fiduciary law” and, therefore, “some conceptual guidance to the corporate community may be helpful.”\(^ {160}\) Likewise, even as it rejected the plaintiffs’ claims against the defendant-directors, the *Disney* court found it


\(^{156}\) *Weinberger*, 457 A.2d at 709 n.7.


\(^{158}\) *In re the Walt Disney Co. Deriv. Litig.* 906 A.2d 27 (Del. 2006).

\(^{159}\) *Id.* at 63. In rejecting the plaintiff’s fiduciary duty of good faith claims, the *Disney* court reasoned that, even if it were to adopt the plaintiff’s standard for “good faith,” the evidence showed the defendant-directors’ actions had satisfied that standard.

\(^{160}\) *Id.* at 64.
“helpful” to outline “best practices” with respect to board deliberations on executive compensation.\textsuperscript{161} Like Weinberger, this portion of Disney’s dictum has since transformed into standard corporate practice.\textsuperscript{162}

While the above examples draw from Delaware’s rich corporate law tradition, the liberal use of judicial dictum has not been confined to the corporate law context. Recall, for example, the supreme court’s dictum in Gotham Partners.\textsuperscript{163} More recently, consider Olson v. Halvorson, where the court considered the applicability of the statute of frauds to oral LLC agreements.\textsuperscript{164} At the time, Delaware’s LLC statute did not specifically address the matter.\textsuperscript{165} And although the supreme court recognized that the question did not affect the outcome of the Olson litigation, the court nonetheless addressed the issue because it “could considerably impact the drafting and enforcement of LLC agreements.”\textsuperscript{166}

\textsuperscript{161} Id. at 56.


\textsuperscript{163} See supra Part II.A.

\textsuperscript{164} See Olson v. Halvorsen, 986 A.2d 1150, 1159-61 (Del. 2009).

\textsuperscript{165} The Delaware legislature has since amended the LLC statute to except oral LLC agreements from the statute of frauds’ writing requirement, thus undoing Olson’s dictum. See SYMONDS & O’TOOLE, supra note __, § 4.02[A], App. B-18.

\textsuperscript{166} Olson, 986 A.2d at 1159.
In this sense, Olson, like Gotham Partners before it, merely continued a Delaware tradition, in which its courts have freely embraced dictum to address matters “beyond ... the issues that the parties present[ed].”\(^{167}\) And in this sense Gatz marks an ironic departure, because the supreme court used dictum to decry dictum as “beyond the proper purview and function of a judicial opinion.”\(^{168}\)

2. Dictum’s Guidance, Regulatory and Responsive Functions

The Delaware courts’ liberal use of dictum has not gone unnoticed in academia or practice. Indeed, this curiously frequent judicial custom has been recognized by scholars, attorneys and jurists alike as serving three important functions.

First, Delaware courts have used dictum to serve a valuable guidance function by addressing areas where the law is ambiguous or otherwise uncertain.\(^{169}\) Such uncertainty is particularly endemic in the transactional context, where the fiduciary obligations of managers and controlling shareholders are notoriously indeterminate.\(^{170}\) In this context, Delaware courts have used dictum to provide crucial guidance for attorneys and their clients on how to structure transactions to

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\(^{168}\) Id.
comply with applicable fiduciary obligations.\textsuperscript{171} Weinberger’s dictum typifies this guidance function. The supreme court’s famous footnote 7 provided a blueprint for future squeeze-out mergers to meet the fiduciary standard of entire fairness.\textsuperscript{172} Such dictum enhances the predictability and clarity of Delaware law where an applicable legal standard is vague or indeterminate.\textsuperscript{173} But dictum has also proven useful to provide guidance where the law is simply silent.\textsuperscript{174} For example, the dicta in \textit{Smurfit-Stone, Gotham Partners, Disney} and \textit{Olson} all provided clarity by filling gaps in Delaware’s statutes and judicial precedents.

Second, Delaware courts have used dictum to serve an important regulatory function. Specifically, dictum has enabled Delaware’s judges to act more like legislators, with the flexibility to address matters beyond the specific disputes before them.\textsuperscript{175} Delaware courts have often created new, broadly applicable rules through the use of dictum by emphasizing where a particular litigant’s conduct fell short of ideal standards.\textsuperscript{176} \textit{Disney’s} judicially-blessed “best practices,” for

\begin{footnotes}
\item[171] See Rock, \textit{supra} note \textit{___}, at 1039 (observing, in the context of management buyout transactions, the use of dicta to provide “guidance” as to “what kind of behavior … are likely to … be a breach of fiduciary duty”); Branson, \textit{supra} note \textit{___}, at 103 (describing the use of judicial “roadmaps” to provide guidance).

\item[172] See Weinberger v. UOP, Inc., 457 A.2d 701, 709 n.7 (Del. 1983).

\item[173] See Cleveland, \textit{supra} note \textit{___}, at 1845;

\item[174] See Steele & Verret, \textit{supra} note \textit{___}, at 192 (arguing that “dicta[] provides useful insight into how open questions not part of the ruling might be expected to play out in the future”); \textit{see also} Cleveland, \textit{supra} note \textit{___}, at 1846-49 (describing the use of dictum to address a question left unaddressed by the Delaware corporate statute).

\item[175] See Jill E. Fisch, \textit{The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters}, 68 U. CIN. L. REV. 1061, 1079-81 (2000); Cleveland, \textit{supra} note \textit{___}, at 1859-60; \textit{cf.} Savitt, \textit{supra} note \textit{___}, at 588-89 (likening the expertise and regulatory flexibility of the Delaware court of chancery to an administrative agency).

\item[176] See Johnson, \textit{supra} note \textit{___}, at 925-28 (describing the use of judicial criticism in dictum to shape executive compensation practices); Ronald J. Gilson, \textit{The Fine Art of Judging: William T. Allen}, 22 DEL. J. CORP. L. 914, 917-18 (1997) (describing the use of judicial criticism in dictum to influence practices surrounding management-buyout transactions); Rock, \textit{supra} note \textit{___}, at 1028-39 (same).
\end{footnotes}
instance, provided not-to-so subtle notice of the conduct that will be expected of corporate directors in future lawsuits. Such prospective lawmaking is particularly desirable given the unique circumstances of Delaware’s judges, who, unlike politically-minded, often part-time legislators, are expert on business law matters and apolitical, selected on the basis of merit through a nonpartisan process. Beyond expanding the regulatory reach of Delaware’s skilled judges, however, lawmaking through dictum provides a second advantage: it avoids the potentially unfair retroactive application of newly announced rules on the parties who brought the litigation. Thus, in Caremark, Chancellor Allen introduced a heightened standard for directors’ oversight obligation in a case where, given the procedural posture, the newly announced rule had no effect on the litigants before him.

Third, and related to its regulatory function, Delaware courts have used dictum to ensure the law is responsive, adaptive to changes in the market and regulatory environment. Through dictum, Delaware judges have often updated the law to address the concerns of investors and regulators. Caremark and Disney exemplify this responsiveness function. The dicta in each

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177 See In re the Walt Disney Co. Deriv. Litig. 906 A.2d 27, 56 (Del. 2006).
178 See, e.g., Fisch, supra note ___, at 1088-96; see also Randy J. Holland & David A Skeel, Jr., Deciding Cases without Controversy, 5 Del. L. Rev. 115, 121-24 (2002) (describing Delaware’s judicial selection process).
179 See Savitt, supra note ___, at 590-91; Cleveland, supra note ___, at 1850.
181 See, e.g., Cleveland, supra note ___, at 1845-46; Fisch, supra note ___, at 1085-88; Gilson, supra note ___, at 917-18.
182 See Fisch, supra note ___, at 1087-88; Gilson, supra note ___, at 917-18 cf. Rock, supra note ___, at 1095 (describing, in the context of management-buyout transactions, the Delaware courts’ use of dicta to address “rapidly developing transactional forms ... in the absence of a case raising just the right issue and in the absence of the articulation (or articulability) of a governing rule”).
decision updated Delaware law to address growing concerns regarding corporate criminal malfeasance\textsuperscript{183} and executive compensation.\textsuperscript{184} Such use of dictum has ensured that Delaware law is nimble and current, without the need to wait for legislative action or a case that squarely raises a particular issue.

The liberal use of dictum in the advance of these guidance, regulatory and responsiveness functions has been praised by many as a distinguishing and invaluable feature of Delaware law and its lawmaking process. For example, in reference to the chancery court’s early hostile takeover decisions, Professor Ron Gilson described the doctrinal guidance provided by dictum as “a creative and elegant response to the problem of keeping the law moving at a pace at least close to that of the market.”\textsuperscript{185}

Professor Ed Rock has made a similar observation with respect to the Delaware courts’ use of dictum to address the rise of management-buyout transactions.\textsuperscript{186} In what he famously described as “corporate law sermons,”\textsuperscript{187} Rock documented the courts’ use of “fact-intensive, normatively saturated” opinions to “provide[] guidance applicable to future cases, that is, what kind of behavior the courts are likely to find to be a breach of fiduciary duty.”\textsuperscript{188}

\textsuperscript{183} See Caremark, 698 A.2d at 960-61 (reasoning that an update to director oversight obligations is warranted “in light of [subsequent] developments,” most notably “an increasing tendency, especially under federal law, to employ the criminal law to assure corporate compliance with external legal requirements”).


\textsuperscript{185} Gilson, supra note ___, at 917-18.

\textsuperscript{186} See generally Rock, supra note ___.

\textsuperscript{187} Id. at 1016.

\textsuperscript{188} Id. at 1039.
Building on these observations, Professor Jill Fisch has argued that the liberal use of dictum, in part, makes the Delaware courts peculiarly vital to the state’s success in attracting corporate charters. As Fisch explained, the Delaware courts have, through the use dictum, created a lawmaking process “characterized by a high degree of flexibility and responsiveness,” one that is “ideally suited to respond to developments in the business world.” Echoing Fisch’s thesis, Professor Steven Cleveland has argued that the role dictum plays in the state’s lawmaking process has given Delaware a competitive advantage over other states in the market for corporate charters.

More recently, attorney William Savitt has written in “praise of dictum,” describing it as the “genius” of the Delaware courts. Like Fisch and Cleveland before him, Savitt argues that the use of dictum has afforded Delaware’s expert judges the flexibility and regulatory reach more typically associated with notice-and-comment rulemaking by an administrative agency.

Despite such praise, there is, naturally, a danger presented by dictum—namely, that it can be the product of unconsidered judgment. When a court announces a rule in dictum, the rule may have pernicious, unintended consequences; because in the absence of concrete facts, an actual dispute and real world litigants, the court may lack a clear understanding of how that

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189 See Fisch, supra note ___, at 1064.
190 Id. at 1064.
191 Id. at 1087.
192 See Cleveland, supra note ___, at 1842-64.
193 Savitt, supra note ___, at 587-91.
194 See id. at 587-97; see also Cleveland, supra note ___, at 1860 (likening Delaware courts to federal administrative agencies).
195 See Savitt, supra note ___, at 588 (summarizing this danger of dictum).
rule may affect parties in the broader gamut of cases. But the Delaware judiciary is uniquely situated to avoid these pitfalls, given its expertise in corporate and business law matters, its intensive engagement with the bar and scholars, and the frequency with which it faces business-related litigation.

Indeed, the value of dictum is not lost on the members of the Delaware judiciary. And here, perhaps, is the strangest aspect of the supreme court's Gatz opinion. Despite the supreme court's stern disapproval of dictum as "improvident and unnecessary," the court's chief justice wrote quite favorably on the judicial practice just five years earlier. In a co-authored article rebutting the common critique that Delaware corporate law is overly indeterminate, Chief Justice Steele argued that dictum provides an important "guidance function:"

...Delaware judges have frequently crafted dicta to give valuable guidance to deal lawyers on unanswered questions. The Delaware courts recognize the need to wait for a live controversy to resolve an issue

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197 See Savitt, supra note __, at 591-97. Alternatively, one could argue that dictum is a useful facet of legal reasoning, often necessary to arrive at a holding. See Johnson, supra note __, at 939-41 (using the example of Disney to make this argument).


200 See Steele & Verret, supra note __, at 207-12.


202 See Steele & Verret, supra note __, at 192.
definitively, but fortunately they also recognize that this does not mean that they cannot, or should not, use the attention paid to a published opinion to offer guidance on uncertain but vital areas of corporate law.\footnote{203}

Beyond mere guidance, however, the chief justice also recognized the value of dictum’s regulatory function, highlighting instances where Delaware courts have strategically used dictum to provide a “lesson” or “warning” of what conduct will and will not be tolerated in future cases.\footnote{204} The chief justice concluded his article by observing that the legal guidance provided, in part, through dictum “is an important element of Delaware’s unique advantage as a forum for the resolution of the disputes of business entities.”\footnote{205}

\section*{C. Compromise over Precedent and Dictum}

Given the chief justice’s apparent onetime affection for the use of dictum, it is ironic that the supreme court in Gatz cited the chief justice’s article to scold against the judicial practice.\footnote{206} It is moreover ironic that, despite the supreme court’s frequent willingness to use dictum to provide doctrinal guidance,\footnote{207} in Gatz it entirely avoided the default duties question. Instead of guidance, all it could muster was that “reasonable minds could differ.”\footnote{208}

\begin{footnotesize}
\begin{enumerate}
\item \footnote{203} Id. at 207 (emphasis added).
\item \footnote{204} Id. at 207-08, 211.
\item \footnote{205} Id. at 219.
\item \footnote{206} See Gatz, 2012 WL 5425227, *10 n. 73.
\item \footnote{207} See supra Part III.B.1.b.
\item \footnote{208} Id. at *10.
\end{enumerate}
\end{footnotesize}
Even if the chancellor's consideration of the default duties question can be fairly characterized as dictum, it served—to use the chief justice's words—an important “guidance function.”

Through it, Chancellor Strine provided definitive guidance as to a fundamental question—a question on which the Delaware legislature seems to have purposefully deferred to the judiciary. The Delaware Supreme Court, by contrast, in rebuking the chancellor's conclusion, provided no guidance on the underlying default duties question. Instead, the supreme court created uncertainty and then left it to fester.

Given all of this, one wonders what led the Delaware Supreme Court to this unlikely opinion—to dismiss Chancellor Strine's resolution of the default duties question as “improvident and unnecessary” dictum by employing a strained interpretation of contractual language and its own precedent, thus creating and leaving unanswered uncertainty on a fundamental legal question. The above context strongly suggests that Gatz was a strategic compromise—one that allowed the supreme court to preserve unanimity by avoiding a divisive question.

The strong preference for unanimity among the Delaware Supreme Court justices is well documented. It is rare for the

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209 See Steele & Verret, supra note __, at 192.

210 See Gattuso, supra note ___ (arguing that Chancellor Strine Gatz opinion “provided needed clarity to Delaware alternative entity law by confirming what practitioners have long thought....”)

211 See supra note __.

212 Gatz, 2012 WL 5425227, *10 (“We decline to express any view regarding whether default fiduciary duties apply...”)

213 In this regard, the supreme court's Gatz opinion may be another example of the kind of strategic decision-making described by Professor Steven Davidoff. See Davidoff, supra note __, at 534-543.

214 See generally David A. Skeel, Jr., The Unanimity Norm in Delaware Corporate Law, 83 Va. L. Rev. 127 (1997).
court to issue a dissenting opinion.\textsuperscript{215} Professor David Skeel has found that over a 36 year period the Delaware Supreme Court failed to issue a unanimous opinion in just 3\% of its cases.\textsuperscript{216} Skeel argued that the supreme court uses unanimity to enhance and preserve its legitimacy as the national arbiter in corporate law matters.\textsuperscript{217} But he also observed that the court’s strong desire to speak with a unified voice may have undesirable consequences. Most notably, unanimity means the court must sometimes accommodate divergent judicial perspectives in a single opinion.\textsuperscript{218} Unanimity can thus prevent the court from staking out a definitive position on a particular issue, allowing for doctrinal instability in future cases.\textsuperscript{219}

Beyond creating doctrinal instability over a span of decisions, however, the Delaware Supreme Court’s preference for unanimity can also lead to doctrinal compromises in a single opinion.\textsuperscript{220} The supreme court’s surprising revision of the fiduciary good faith duty in \textit{Stone v. Ritter} may be a product of

\textsuperscript{215} The reasons for the endurance unanimity norm at the supreme court are several: (i) the non-partisan merit-based process by which justices are selected, which ensures that the justices are likely to be like minded; (ii) the small-size of the supreme court bench of only five justices, which as opposed to larger benches, reduces the likelihood of factions among its members; and (iii) the court’s internal operating procedures, which are designed in a manner to ensure a deliberative process that promotes consensus. See Skeel, \textit{supra} note \underline{ ___}, at 133-37; see generally Holland & Skeel, \textit{supra} \underline{ ___}.

\textsuperscript{216} See Skeel, \textit{supra} note \underline{ ___}, at 132, 174-75.

\textsuperscript{217} See \textit{id.} at 170-71 (“If the court regularly issued separate opinions, the justices’ internal disagreements would dilute the impact of the court’s pronouncements.... Speaking instead with a single voice, the justices send a very different message, one that suggests that the full authority of the court stands behind the conclusions that they reach....”). Indeed, a sizable majority of those cases in which the supreme court failed to issue a unanimous opinion were unrelated to corporate law matters. \textit{Id}.

\textsuperscript{218} See \textit{id.} at 146-48.

\textsuperscript{219} See \textit{id.} at 137-53.

\textsuperscript{220} See \textit{id.} at 154-55.
As Professor Stephen Bainbridge observed in his critique of the *Stone* decision, the incorporation of good faith into the fiduciary duty of loyalty appears to be unfortunate compromise between divergent views as to the status of good faith among the Delaware justices.\(^{222}\)

*Gatz* appears to be another example of the Delaware justices' willingness to compromise doctrine to avoid internal division. On one side is the Delaware chief justice, who has been outspoken in his belief that there are no default fiduciary duties in the LLC context.\(^{223}\) But the *Gatz* opinion suggests that there remains a faction—perhaps all four of the other justices—who disagree with the chief justice's construction of the Delaware LLC statute or the wisdom of overruling a long line of chancery court precedent.\(^{224}\) By purporting to resolve the litigation “solely on contractual grounds,”\(^{225}\) the court was able to preserve unanimity, avoiding altogether the divisive question.\(^{226}\) Instead, it was able to dismiss the chancellor's consideration of the default duties issue as “improvident and unnecessary” dictum, hoping—even inviting—the Delaware General Assembly to legislatively resolve the matter.\(^{227}\)


\(^{222}\) Id. at 584.

\(^{223}\) See supra Part II.B; see also Q&A with Chief Justice Myron T. Steele of the Delaware Supreme Court, Practical Law The Journal (December 2012), at http://us.practicallaw.com/3-515-1049.

\(^{224}\) See supra note __.


\(^{226}\) Here, Skeel's analysis seems prescient. The supreme court's strong desire to speak with one voice, Skeel explained, makes it more likely that individual justices' will “take the intensity of a particular judge's preference into account in the decision making process.” See Skeel, supra note __, at 154-55.

\(^{227}\) *Gatz*, 2012 WL 5425227, *10* (“[T]he organs of the Bar ... may be well advised to consider urging the General Assembly to resolve [the] statutory ambiguity on this issue.”).
The desire for unanimity may well explain the Gatz decision. After all, unlike the corporate law context, with respect to LLC law, the Delaware judiciary is still establishing its reputation.\textsuperscript{228} A divided opinion, especially on such a high-profile question, could serve to damage the Delaware’s authoritative status on LLC law matters. But the trouble with this compromise, or whatever led the Delaware Supreme Court to its unlikely \textit{per curiam} opinion, is that by decrying dictum, rather than addressing the underlying substantive legal question, the court has created a precedent that undermines both the certainty of Delaware law as well as the judicial tool long used by Delaware courts to resolve such uncertainty.

\textbf{IV. IMPLICATIONS OF GATZ}

The fallout from \textit{Gatz} will be far reaching, affecting Delaware, its law and those in practice. In practice, \textit{Gatz} will change how LLC agreements are both drafted and interpreted. As for Delaware, \textit{Gatz} will, in the near term, prompt an amendment of the state’s LLC statute. In the long term, however, \textit{Gatz} will have lingering, less tangible consequences on the state’s reputation for legal certainty as well as its lawmaking process.

\textbf{A. Implications for LLC Agreements}

The most obvious effect of \textit{Gatz} will be on the drafting of LLC agreements. In this regard, Chief Justice Steele has won the default duty debate as a practical matter, even without winning a definitive ruling on the question. Until the Delaware General Assembly acts to resolve the uncertainty created by \textit{Gatz} as to

the default duties owed by LLC managers, the uniform advice of practitioners has been to expressly articulate in an LLC agreement the fiduciary duties the parties intend, lest the supreme court subsequently finds that such duties do not apply as a default. 229

The more troublesome effect of Gatz will be to existing LLC agreements. 230 Before Gatz, the standard assumption was that traditional fiduciary duties are the default duties to the extent such duties are not modified or waived by an LLC agreement’s express provisions. 231 Accordingly, parties drafted LLC agreements focusing their attention on how the express terms modified or restricted traditional fiduciary duties, if such duties were not wholly eliminated by the agreement. 232 This assumption was, no doubt, based in part on the chancery court’s pre-Gatz precedent. 233 But it was also based on the legislative

229 See Batey, “Delaware Supreme Court Introduces Uncertainty,” supra note ___; Norman & Mercer, supra note ___; Mahler, “Delaware Supreme Court Reboots Question,” supra note ___; Gibson Dunn & Crutcher, LLP, supra note ___.
230 See Batey, “Delaware Supreme Court Introduces Uncertainty,” supra note ___, (describing the “suddenly shifted landscape” that Gatz has created for existing LLC agreements).
231 See supra notes ___ & ___.
232 Chancellor Strine made this very same observation in Gatz:

“From my experience as a trial judge, I note that few LLC agreements contain an express, general provision that states what fiduciary duties are owed in the first instance. Rather, the agreements assume that such fiduciary duties are owed, and then they proceed to cut back on liability for breaches of those duties through exculpation provisions or through provision that displace traditional duties in favor of a contractual standard....”

233 See supra note ___. Some have pointed to then-Chancellor Chandler’s decision in Fisk Ventures, LLC v. Segal as a counterexample to these rulings, arguing that Fisk ruled there are no default fiduciary duties. See, e.g., Steele, Freedom of Contract and Default Contractual Duties, supra note____, at 229-30; Sciotto, supra note____, at 547-58. But the LLC agreement at issue in Fisk included an express waiver provision that “eliminate[ed] fiduciary duties to the maximum extent provided by law by flatly
history following *Gotham Partners*. And it was based on the supreme court’s own precedent, linking the Delaware LLC statute to the LP statute and rejecting a construction of the LLC statute that would implicitly repeal established doctrine.

Whatever the reasons for this assumption, an unknowable number of LLC agreements were made that did not expressly impose fiduciary duties because the parties understood such duties applied already as a default matter.

In oral arguments before the Delaware Supreme Court, the minority members’ counsel made this very argument: “In light of the legislature’s acceptance of [the supreme court’s ruling in *Gotham Partners*], and then the implication of the waiver provision [added to the Delaware LLC statute,] a lot of folks out there have conformed their conduct based upon at least how the legislature reacted.” On this point, the chief justice interjected, “There is not one iota of empirical data to support that conclusion in the record.”

The chief justice is correct: there is little empirical data on how Delaware LLC agreements actually address fiduciary duties. The vast majority of LLCs are private, rather than

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234 See *Auriga*, 40 A.3d at 851-52.
236 See *Olson v. Halvorsen*, 986 A.2d 1150, 1160-62 (Del. 2009) (reasoning, with respect to the Delaware LLC act and the statute of frauds, that the court “will not do by judicial implication what the General Assembly itself has declined to do by express legislation”).
238 *Id.*
Therefore, large samples of actual LLC agreements are not readily available. But there is strong indirect evidence to suggest that before Gatz practitioners understood fiduciary duties to be the default duties and accordingly drafted LLC agreements. For one, just ask any attorney. When Professor Frank Gervutz interviewed attorneys as to why they preferred forming LLCs under Delaware’s statute, the most frequent response was the freedom of contract afforded by Delaware law, including the ability to waive fiduciary duties. The implication of this finding is, naturally, that the interviewed attorneys understood fiduciary duties to apply as a default; otherwise, there would be nothing to waive. And this was not the understanding of a few isolated or unsophisticated bumpkin lawyers. It is reflected in the most widely-used LLC treatises.

And it is consistent with what one sees in case law, where LLC

239 By recent counts, Delaware is home to well over one-half million LLCs, of which only 12 are publicly traded. See A. Gilchrist Sparks, “Legislative Developments in Delaware’s ‘Alternative Entities’,” Harvard Law School Forum on Corporate Governance and Financial Regulation, at http://blogs.law.harvard.edu/corpgov/2011/09/08/legislative-developments-in-delaware%E2%80%99s-%E2%80%9Calternative-entities%E2%80%9D/ (noting that 550,238 Delaware LLCs were in existence as of the end of 2010); Manesh, Contractual Freedom, supra note __, at 598-603 (identifying only 12 publicly-traded Delaware LLCs as of mid-2011).

240 The extant studies that have looked at actual LLC agreements have focused on discrete, unrepresentative sets of publicly-available agreements. See, e.g., Harner & Marincic, supra note __, at 898-99 (analyzing agreements of 150 LLCs in which one or more party is a public company); Manesh, Contractual Freedom, supra note __, at 571-72 (analyzing agreements of publicly-traded LLCs).

241 See supra note ___.


243 SYMONDS & O’TOOLE, supra note ___, § 9.04[B][3] (“It seems clear that, in the absence of appropriate provision in the limited liability company agreement, there are circumstances in which a member or manager or other person holding management power owes fiduciary duties.”); J. WILLIAM CALLISON AND MAUREEN A. SULLIVAN , LIMITED LIABILITY COMPANIES: A STATE-BY-STATE GUIDE TO LAW AND PRACTICE, (Westlaw 2012 Ed.) (“In Delaware, absent a provision to the contrary in the operating agreement, LLC managers owe "the traditional fiduciary duties of loyalty and care to the members of the LLC."”); RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES, § 9:4 (“In general, default [fiduciary] duties remain under the Delaware statute except to the extent the agreement explicitly disclaims or limits them.”).
agreements tend to assume fiduciary duties exist in the first instance and then proceed to cut back on those duties with contractual standards that address specific types of transactions and exculpation provisions.  

Ultimately, it is unknowable the number of existing LLC agreements that were drafted in reliance on a now contestable assumption. But for those that were and that did not otherwise expressly address the managers’ fiduciary duties, the members are now faced with the uncomfortable decision: either live with the specter that there are no default fiduciary protections or return to the bargaining table to amend their LLC agreement, knowing that emboldened by Gatz, managers may ask for additional concessions in exchange for affirmative provisions that impose fiduciary-like obligations.

B. Implications for Delaware

With respect to Delaware’s LLC law, its courts and its reputation, the Gatz decision will have both short-term and long-term consequences. In the short term, Gatz will inevitably prompt an amendment to the state’s LLC statute to resolve the uncertainty Gatz has created. The longer term consequences, however, are ones that cannot be resolved by a simple legislative amendment.

1. Amendment to the LLC Statute

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244 See supra note ___.

245 Note that for parties that did not assume fiduciary duties to be the default, Gatz is of little consequence, because such parties were presumably express in the LLC agreements as to the obligations they intended. Thus, Gatz only adversely effects those LLC agreements in which the parties did not affirmatively impose fiduciary duties because they believed such duties to be the default.
In the near term, the uncertainty created by *Gatz* will almost certainly spur the Delaware General Assembly into action. Indeed, the Delaware Supreme Court explicitly invited legislative intervention in its decision. In declining to opine on the default duties question, the court conspicuously added “the organs of the Bar” responsible for proposing amendments to Delaware’s business entity statutes “would be well advised to consider urging the General Assembly to resolve [the] statutory ambiguity on this issue.”\textsuperscript{246} Given the Delaware legislature’s alacrity to correct past judicial precedents that it has viewed as problematic,\textsuperscript{247} a legislative resolution to the default duty question should be forthcoming in the very near future.

When the Delaware General Assembly does act, it seems all but certain that the legislature will amend the Delaware LLC statute to confirm the chancery court’s construction. Indeed, the General Assembly’s response to the dictum of *Gotham Partners*—by specifically providing that fiduciary duties may be contractually eliminated altogether\textsuperscript{248}—seems to confirm the legislature’s prior understanding that fiduciary duties exist as a default.\textsuperscript{249} Moreover, as a prudential matter, unlike the Delaware Supreme Court, the Delaware General Assembly is likely to be swayed by the reliance and settled expectations that have developed over time around that understanding.\textsuperscript{250}

\textsuperscript{246} *Gatz*, 2012 WL 5425227, *10.

\textsuperscript{247} Within months of *Gotham Partners* and *Olson*, respectively, the Delaware General Assembly approved amendments to the Delaware LLC statute to overturn the dicta of each opinion. See supra notes ___ & ___.

\textsuperscript{248} See supra note ___.

\textsuperscript{249} CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 14.05 (“The chances are remote, at best, that the Delaware legislature would have intended the LLC amalgam to be completely free of fiduciary duties. It is inconceivable that the legislature would have taken such a radical step *sub silentio*.”).

\textsuperscript{250} See supra note ___. 
Ironically, the resulting amendment will reprise the *Gotham Partners* experience.\footnote{See supra Part II.A. Moreover, to the extent Gatz will result in the Delaware legislature overturning what it views to be problematic Delaware Supreme Court dictum, Gatz will be reminiscent of *Olson v. Halverson*. See supra notes \textsuperscript{__}.}

In the meantime, however, the chancery court continues to be bound to its own precedent.\footnote{See *Gatz*, 2012 WL 5425227, *10 ("It is axiomatic, and we recognize, that once a trial judge decides an issue, other trial judges on that court are entitled to rely on that decision as *stare decisis*.").} Even after *Gatz*, the chancery court will continue to apply fiduciary duties in LLCs as a default absent definitive supreme court guidance to do otherwise.\footnote{See Feeley v. NHAOCG, 2012 WL 5949209, *8 (Del. Ch. Nov. 28, 2012).}

2. *Lingering Harm to Reputation and Law-Making Process*

Longer term, *Gatz* will have more intangible consequences that cannot be repaired by a legislative amendment. In an apparent search for unanimity, the supreme court undermined both Delaware law’s reputation for certainty as well as a judicial tool long used to foster that reputation.

With respect to the former, a prevailing perception of certainty, accreted over time through the accumulation of judicial precedent, has long been a key attraction of Delaware law for corporations.\footnote{See, e.g., Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1212 (2001); Kamar, supra \textsuperscript{__}, at 1923-24; Macey & Miller, supra note \textsuperscript{__}, at 484; Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225, 274 (1985).} And while the LLC form is still relatively new, Delaware’s LLC case law is burgeoning\footnote{See Manesh, *Delaware and the Market for LLC Law*, supra note \textsuperscript{__}, at 212-14.} such that practitioners now frequently cite the predictability and
clarity of the state’s law as a reason for preferring it for LLCs as well.256

Gatz goes far to undermine these perceptions—“to erode the state’s credibility” as Chancellor Strine cautioned.257 Just ask anyone who relied on Delaware’s pre-Gatz precedent in drafting to an LLC agreement.258 Unmoved by such reliance, the supreme court refused to embrace established chancery court doctrine, despite conceding that the LLC statute is “ambiguous” and that “reasonable minds could differ” on the default duties question.259 Instead, the court seemed to prefer unanimity over doctrinal stability.

Beyond challenging the supposed predictability of Delaware law, however, Gatz also challenges its reputation for clarity and guidance. In repudiating the chancery court’s opinion, the supreme court failed to provide any guidance on the now uncertain default duties question.260 Rather, the supreme court left uncertainty to linger and instead attacked the judicial tool often used to resolve such questions. In the past, I have argued that the ultimate resolution of the default duties question has limited practical consequence, because the parties likely to form and invest in Delaware LLCs can also ably contract out of the default duties if they find such duties undesirable.261 But the problem with Gatz is that in its wake even the most

256 See Gervutz, supra note __, at 108. But see Manesh, Delaware and the Market for LLC Law, supra note __, at 234-39 (arguing that in the context of Delaware LLC law a large volume of existing or new judicial precedent provides less value than in the corporate law context because of the freedom of contract afforded under LLC law).
257 See Auriga, 40 A.3d at 854.
258 See supra note __.
260 See Gatz, 2012 WL 5425227, *10 (“We decline to express any view regarding whether default fiduciary duties apply....”).
261 See generally Manesh, What is the Practical Importance of Default Rules under Delaware LLC and LP Law?, supra note __.
sophisticated parties cannot know *what are* the default duties. Their only option is now to explicitly articulate the duties they intend in their LLC agreement.\textsuperscript{262}

With respect to its treatment of dictum, *Gatz* is likewise problematic, because it attacks a fundamental facet of the Delaware lawmaking system, one that even the chief justice himself recognized as providing the state a “unique advantage.”\textsuperscript{263} Dictum is, in part, what has given Delaware law its flexibility and predictability. It is what Delaware courts have long used to address uncertainties like the one *Gatz* has created. If the chancery court were, in fact, to heed the supreme court’s stern instructions—to focus solely on “the issues that the parties present” and to avoid dictum\textsuperscript{264}—Delaware law would forego part of what has made the state so attractive for corporations and, more recently, LLCs.

To “stray[] beyond ... the issues that the parties present[ed],”\textsuperscript{265} however, is a deep-rooted judicial tradition in Delaware. So, it is unlikely that Delaware courts will soon cease the practice of using dictum. But even if the chancery court ignores the supreme court’s instructions, *Gatz* serves as a sharp reminder that the supreme court is untroubled by the expectations and reliance that may develop around dictum,\textsuperscript{266} thus undermining the value of the judicial practice.

\textsuperscript{262} The only good news is that unlike the indeterminate mandatory rules of corporate law, the uncertainty created by *Gatz* is one that can be eliminated within the terms of an LLC agreement. See supra note \textsuperscript{___}; cf. Manesh, *Delaware and the Market for LLC Law*, supra note \textsuperscript{___}, at 226-34 (arguing that Delaware LLC law affords LLCs to the contractual freedom to avoid the indeterminate mandatory rules of corporate law).

\textsuperscript{263} Steele & Verret, supra note \textsuperscript{___}, at 219.


\textsuperscript{265} Id.

\textsuperscript{266} See supra notes \textsuperscript{___}.
V. Conclusion

The question of whether LLC managers owe fiduciary duties is a fundamental question of LLC governance. But under Delaware law, today, the answer to that question is uncertain. Its statute is silent, and Gatz left the matter “open.”267

The Delaware legislature may well now act to resolve the uncertainty Gatz has created. But what the legislature cannot repair is the harm that Gatz may have on Delaware’s reputation and the role of dictum in the state’s lawmaking process.