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Equity in LLC Law?

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EQUITY IN LLC LAW?

MOHSEN MANESH*

ABSTRACT

*To what extent does equity play a role in LLC law? To what extent do courts retain the judicial discretion “to do right and justice” in circumstances in which the LLC statute and the applicable LLC agreement do not otherwise offer an adequate remedy to an aggrieved LLC member or manager? Until recently, the answer to these questions was quite clear: Equity is subordinate to the freedom of contract and the express terms of the agreement governing an LLC. But the Delaware Chancery Court’s decision in *In re Carlisle Etcetera* has upended this basic percept of LLC law and practice. Carlisle suggests that courts need not sheepishly defer to the express terms of an LLC agreement. Instead, where justice dictates a different result, Carlisle suggests that courts retain the equitable power to apply fiduciary standards or recognize other equitable rights or duties, despite the statutorily mandated freedom of contract under LLC law. Thus, this Article argues that Carlisle represents a true paradigm shift. It inverts the long-assumed supremacy of contract over equity in LLC law. Instead, the freedom of contract must be exercised always in the shadow of equity.*

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I. INTRODUCTION

To what extent does equity play a role in limited liability company (“LLC”) law? To what extent do courts retain the judicial discretion “to do right and justice” in circumstances in which the LLC statute and

* Associate Professor, University of Oregon School of Law. The Author thanks Lyman Johnson, Peter Molk, Tom Rutledge, and Park Bramhall as well as the participants at the 2016 National Business Law Scholars Conference at the University of Chicago Law School for their thoughtful comments to earlier drafts of this Article. The Author is also grateful to Eleanor Vincent, Derek Berry, Josanne Jeremiah, Eric Boothe, and Nick Pepler for their productive research assistance on various topics related to this project.

the applicable LLC agreement do not otherwise offer an adequate remedy to an aggrieved LLC member or manager?¹

This question is particularly relevant in Delaware, which plays an outsized role in LLC law due to its status as the leading legal haven for LLCs.² Unlike many other states' statutes, Delaware's LLC statute purports to "give the maximum effect to the principle of freedom of contract and to the enforceability of [LLC] agreements."³ Exercising this freedom of contract, LLC parties routinely agree to limit or wholly eliminate fiduciary duties,⁴ the judge-made duties that courts have traditionally applied to ensure equity in business associations.⁵ And in

1. See *Schoon v. Smith*, 953 A.2d 196, 205 (Del. 2008) ("[T]he final object of equity is to do right and justice." (quoting 1 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE, § 60, at 80 (5th ed. 1941))); see also William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery—1792-1992*, 18 DEL. J. CORP. L. 819, 821 (1993) ("[E]quity is a moral sense of fairness based on conscience.").

2. As is the case for corporate charters, Delaware is the preeminent choice of law for large LLCs. See Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 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); Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91, 116 tbl.2 (finding that among closely held LLCs with 50 or more employees that form outside of their home state, more than 61% are organized under and governed by Delaware law); Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189, 202 (2011) [hereinafter Manesh, *Market for LLC Law*] (observing that all 15 of LLCs that filed for or completed an initial public offering during a six-year period ending March 31, 2010 were chartered in Delaware); Jens Dammann & Matthias Schündeln, *Where Are Limited Liability Companies Formed? An Empirical Analysis* 3 (Univ. of Tex. Sch. of Law, Law and Econ. Research Paper No. 126, 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1633472 [<https://perma.cc/ER2M-ZLFF>] (finding that among closely held LLCs with 5000 or more employees that form outside of their home state, more than 95% are organized under and governed by Delaware law); see also Daniel S. Kleinberger, *Two Decades of "Alternative Entities": From Tax Rationalization Through Alphabet Soup to Contract as Deity*, 14 FORDHAM J. CORP. & FIN. L. 445, 460 (2008) ("Delaware law seems to exert an almost gravitation pull' on LLC practice and jurisprudence.").

3. DEL. CODE ANN. tit. 6, § 18-1101(b) (2016).

4. See, e.g., *Wood v. Baum*, 953 A.2d 136, 139 (Del. 2008) (LLC agreement eliminating all liability associated with fiduciary duties, other than for "fraudulent or illegal conduct"); *CNL-AB LLC v. E. Prop. Fund I SPE (MS Ref) LLC*, No. 6137-VCP, 2011 WL 353529, at *9 (Del. Ch. Jan. 28, 2011) (LLC agreement permitting the managing member to act in its "sole and absolute discretion . . . without consideration of any other obligation or duty, fiduciary or otherwise . . ."); *In re Atlas Energy Res., LLC*, No. 4589-VCN, 2010 WL 4273122, at *12-13 (Del. Ch. Oct. 28, 2010) (LLC agreement explicitly eliminating all fiduciary duties owed by officers and directors of a publicly traded LLC); *Fisk Ventures, LLC v. Segal*, No. 3017-CC, 2008 WL 1961156, at *9 (Del. Ch. May 7, 2008) (LLC agreement eliminating all fiduciary duties by explicitly limiting the parties' duties to those "expressly set forth" therein); see also Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. 24, 27 (2016), (providing evidence showing that fiduciary waiver or modification is common among privately held LLCs).

5. See, e.g., J. William Callison & Allan W. Vestal, *Contractarianism and Its Discontents: Reflections on Unincorporated Business Organization Law Reform*, 42 SUFFOLK U. L. REV. 493, 505 (2009) (arguing that fiduciary duties enable courts to "police misconduct . . .

deference to the LLC statute, Delaware courts have found themselves robotically enforcing these agreements without ever seriously questioning whether such enforcement is fair, reasonable, or just given the circumstances.⁶ Thus, until recently at least, based on statute and precedent, the role of equity in LLCs seemed clear: Equity is subordinate to the freedom of contract and the express terms of the agreement governing an LLC.

But the Delaware Chancery Court's decision in *In re Carlisle Etcetera LLC*⁷ has upended this basic precept of LLC law and practice. *Carlisle* suggests that, as a state constitutional matter, Delaware courts need not sheepishly defer to the state's LLC statute or the express terms of an LLC agreement.⁸ Instead, where justice dictates a different result, *Carlisle* suggests that Delaware courts retain the equitable power to apply fiduciary standards or recognize other equitable rights or duties, despite the statutorily mandated freedom of contract. Thus, this Article argues, *Carlisle* represents a true paradigm shift. It inverts the long-assumed supremacy of contract over equity in LLC law. Instead, the freedom of contract must always be exercised in the shadow of equity.⁹

This Article explores the implications of *Carlisle* in four Parts. Part II briefly traces the origins of equity and its role in modern business associations. As this Part explains, although LLC law embraces fiduciary duties and other principles that originated in equity, Delaware's LLC statute and case law also make clear that these equitable principles may be limited or wholly displaced by the terms of an LLC agreement.

Part III then explores the peculiarly constitutional basis for equity in Delaware and its implications for freedom of contract in LLCs. *Carlisle* suggests that, as a state constitutional matter, equity cannot be subordinated by statute or contract. Yet, there is also a problem with *Carlisle*: it squarely conflicts with a previous Delaware Supreme Court opinion, *CML V, LLC v. Bax*, decided just four years earlier.¹⁰ Today,

based on broader societal concepts of fairness"); Kleinberger, *supra* note 2, at 465 ("Fiduciary duty attaches to [business associations] to proscribe and constrain abuses of power.").

6. See, e.g., *Wood*, 953 A.2d at 141-44 (dismissing claims for breach of fiduciary duty in a publicly held LLC); *In re Atlas Energy Res.*, 2010 WL 4273122, at *12-13 (dismissing claims for breach of fiduciary duties in a publicly held LLC); *Related Westpac LLC v. JER Snowmass LLC*, No. 5001-VCS, 2010 WL 2929708, at *7-8 (Del. Ch. July 23, 2010) (dismissing claim for breach of fiduciary duty in a privately held LLC); *Fisk Ventures*, 2008 WL 1961156, at *11 (dismissing claims for breach of fiduciary duty in a privately held LLC).

7. 114 A.3d 592 (Del. Ch. 2015).

8. See *infra* Section III.B.2.

9. Cf. Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979) (demonstrating how the "shadow of the law" forces parties to take into account what would happen in the event of adjudication by a court).

10. 28 A.3d 1037 (Del. 2011).

that conflict remains unresolved. Part IV, however, argues that *Carlisle* signals the demise of *Bax* and a resurgent role for equity in LLCs. Recent developments involving both Delaware's LLC statute and its judiciary support this conclusion.

Still, Part V contends that even if *Carlisle* is proven correct, as a practical matter, equity is unlikely to mount a widespread assault on the freedom of contract in LLCs. Both policy and pragmatic considerations suggest that the Delaware courts will be exceedingly sparing in the use of their constitutionally vested equitable powers. Consequently, the express terms of LLC agreements, including fiduciary waivers, will continue to be routinely enforced in the vast majority of cases. But what *Carlisle* means is that the Delaware courts need not unquestioningly defer to the express language of an LLC agreement in every conceivable circumstance—especially when presented with conduct that is manifestly opportunistic, exploitative, or otherwise inequitable. Thus, the practical consequence of equity for LLC law and governance will be subtle: the very existence of an unwaivable judicial power “to do right and justice” may serve as a prophylactic deterrent against brazen overreach or exploitation.

II. EQUITY AND THE FREEDOM OF CONTRACT IN LLCs

The path to *Carlisle* has its roots in the medieval distinction between law and equity. Section A explores that history and its relevance to contemporary business associations, in particular the recognition in equity that those vested with the legal right of control over a business owe a fiduciary duty to the business and its owners. Section B then explains how the Delaware Chancery Court has adapted this equitable principle to LLCs. Finally, Section C describes the apparent subjugation of equity by freedom of contract under Delaware's LLC statute and case law.

A. *Equity and the Law of Fiduciary Duties*

In medieval England, equity arose as a corrective salve to the injustice wrought by the early common law.¹¹ The early English courts of law applied a highly technical, inflexible system of substantive law and procedure.¹² As a result, petitioners with legitimate claims before

11. See POMEROY, *supra* note 1 §§ 50-51, at 64-65. For a historical perspective on the origins of equity in medieval England and its Greek and Roman antecedents, see generally *id.* §§ 2-39; HENRY L. MCCLINTOCK, *HANDBOOK OF THE PRINCIPLES OF EQUITY*, §§ 1-3 (2d ed. 1948); Howard L. Oleck, *Historical Nature of Equity Jurisprudence*, 20 *FORDHAM L. REV.* 23, 26-40 (1951).

12. See POMEROY, *supra* note 1, at §§ 16-17, at 20-21; Maurice A. Hartnett, III, *The History of the Delaware Court of Chancery*, 48 *BUS. LAW.* 367, 368 (1992).

these early law courts were often denied justice because of the courts' rigid adherence to perceived common law precedents or formalistic technicalities.¹³ These petitioners would sometimes appeal to the king, the realm's ultimate legal authority.¹⁴ As sovereign, the king retained the royal prerogative to ameliorate any harsh results obtained in his law courts—to do justice between subjects by recognizing rights and ordering remedies that were not available in the courts of law.¹⁵ Over time, as the number of these petitions became increasingly burdensome, the king delegated his royal power to do justice first to his highest royal officer, the Chancellor, and eventually to a full-time court, known as the court of chancery or court of equity.¹⁶

Consistent with its origins and purposes, courts of equity developed separate doctrines to provide relief to aggrieved parties where the law courts did not recognize a legal right or provide for an adequate remedy.¹⁷ These equitable doctrines emphasized flexibility and fairness, rather than technicalities or formalism, enabling equity courts to exercise discretion to do justice where the facts of a given case so required.¹⁸ This room for discretion has been famously decried as enabling unpredictable results—that equity is as arbitrary as the size of the “chancellor’s foot.”¹⁹ But judicial discretion is also at the very heart of equity jurisprudence.²⁰ Equity enables a court to take into consideration the special circumstances of a given case in order to do justice

13. See Harnett, *supra* note 12, at 368.

14. *Id.*

15. See Oleck, *supra* note 11, at 33.

16. See MCCLINTOCK, *supra* note 11, § 1, at 2; POMEROY, *supra* note 1 §§ 33-35, at 38-40; Harnett, *supra* note 12, at 368; Oleck, *supra* note 11, at 35-36.

17. See Harnett, *supra* note 12, at 368 (“[C]hancery restricted itself to hearing only those cases where other courts could not afford an adequate remedy.”); Quillen & Hanrahan, *supra* note 1, at 820 (“[The medieval] Court of Chancery . . . provided judicial relief to those left remediless because of the procedural rigidity, corruption, and inadequate enforcement machinery of the common law courts.”).

18. See MCCLINTOCK, *supra* note 11, § 1, at 2; Harnett, *supra* note 12, at 368.

19. English law scholar John Selden famously critiqued the unpredictability of discretion in equity:

Equity is a roguish thing: for [in] law we have a measure [and] know what to trust to; equity is according to the conscience of him that is [the] chancellor, and as that is larger or narrower, so is equity. ‘Tis . . . as if they should make the standard for the measure we call a foot, [to be the] chancellor’s foot; what an uncertain measure would this be? One chancellor has a long foot, another a short foot, [and] a third an indifferent foot: ‘tis the same thing in the chancellor’s conscience.

JOHN SELDEN, THE TABLE TALK OF JOHN SELDEN 62-63 (Edinburgh, Thomas Constable & Co. 1854).

20. See MCCLINTOCK, *supra* note 11, § 23, at 49-52.

where the strict application to law would otherwise serve injustice.²¹ As one former Delaware Chancellor has succinctly described it, “[E]quity is the recognition that the universal rule cannot always be justly applied to the special case.”²²

The American colonies inherited from the English this bifurcated system of law and equity.²³ In fact, after the Revolution, many of the newly independent states continued with separate courts of law and courts of equity.²⁴ Today, while most U.S. jurisdictions have merged the two—empowering courts of general jurisdiction to apply both equitable and legal doctrines²⁵—a small minority retain separate equitable courts of chancery,²⁶ most notably Delaware.²⁷

Many bedrock principles familiar to contemporary business lawyers originated in equity.²⁸ Some examples include the rights of partners to seek judicial dissolution of a partnership where it has become impracticable to carry on the partnership business;²⁹ the derivative standing

21. See MCCLINTOCK, *supra* note 11, § 1, at 2 (defining equity by “the fundamental end of attaining . . . justice in the particular case, and the means of attaining that end by discretion in adapting the remedy to the particular case”); Oleck, *supra* note 11, at 38 (“Necessarily, . . . equity, could not effect substantial justice without by-passing precedent when a situation demanded special treatment.”).

22. Quillen & Hanrahan, *supra* note 1, at 821-22; see also Oleck, *supra* note 11, at 23 (“Equity is the correction of the . . . law where it is deficient by reason of its universality (i.e.: its tendency to establish rules without exceptions.”). As Professor Johnson has pointed out, the idea that the strict application of universal rules may lead to injustice in specific cases is one that dates back to Aristotle. See Lyman Johnson, *Delaware’s Non-Waivable Duties*, 91 B.U. L. REV. 701, 709 (2011).

23. See MCCLINTOCK, *supra* note 11, § 5; Harnett, *supra* note 12, at 368-69 (describing the English heritage of equity in colonial Delaware); Oleck, *supra* note 11, at 40-41; Quillen & Hanrahan, *supra* note 1, at 822-31 (same). See generally Solon D. Wilson, *Courts of Chancery in the American Colonies*, in 2 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 779 (1908) (providing a historical account of the courts of chancery in colonial America).

24. See Oleck, *supra* note 11, at 41.

25. See POMEROY, *supra* note 1 § 40, at 45; Oleck, *supra* note 11, at 42.

26. At the beginning of the twenty-first century, only four states retained separate courts of law and equity: Arkansas, Delaware, Mississippi, and Tennessee. See John J. Watkins, *Law and Equity in Arkansas - Or, Why to Support the Proposed Judicial Article*, 53 ARK. L. REV. 401, 404 (2000). Arkansas merged its courts of law and equity in 2001. See ARK. CONST. amend. 80 § 6(A) (2001).

27. For more on the importance of the Delaware Chancery Court in the business law context, see Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061 (2000); William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture in Providing Justice*, 48 BUS. LAW. 351 (1992); William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570 (2012).

28. Another common business law doctrine sometimes associated with equity is corporate, or limited liability, veil piercing. See, e.g., 18 AM. JUR. 2D *Corporations* § 48 (2016). There is, however, some disagreement among courts as to whether veil piercing is truly an equitable remedy. Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 535 (2001).

29. See, e.g., *In re Carlisle Etcetera LLC*, 114 A.3d 592, 601 (Del. Ch. 2015) (discussing the origins of judicial dissolution in equity).

of shareholders to bring a suit on behalf of a corporation;³⁰ and, most importantly, the fiduciary duties owed by trustees, agents, partners, and corporate directors and officers.³¹

“The hallmark of a fiduciary relationship is that one person has the power to exercise control over the property of another as if it were her own.”³² Hence, the relationship between a trustee and trust beneficiary, between an agent and her principal, among general partners, and between corporate officers and directors and the corporation’s shareholders have all been categorized as fiduciary in nature.³³ In each instance, “one [party] reposes special trust in and reliance on the judgment of another”³⁴ “The relationship connotes a dependence”³⁵—a vulnerability that the party vested with control could exercise that

30. See, e.g., *Schoon v. Smith*, 953 A.2d 196, 201-02 (Del. 2008) (discussing the history of derivative standing in equity); accord *CML V, LLC v. Bax*, 28 A.3d 1037, 1044 (Del. 2011) (quoting *Schoon*).

31. See *Johnson*, *supra* note 22, at 711-13 (describing the origins of fiduciary duty in equity); L.S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 69-72 (same); see also *McMahon v. New Castle Assocs.*, 532 A.2d 601, 604 (Del. Ch. 1987) (Allen, C.) (“Among the most ancient of headings under which chancery’s jurisdiction falls is that of fiduciary relationships. . . . Chancery takes jurisdiction over ‘fiduciary’ relationships because equity, not law, is the source of the right asserted.”).

32. *Sokol Holdings, Inc. v. Dorsey & Whitney, LLP*, No. 3874-VCS, 2009 WL 2501542, at *3 (Del. Ch. Aug. 5, 2009) (Strine, V.C.); accord *Bond Purchase, L.L.C v. Patriot Tax Credit Props., L.P.*, 746 A.2d 842, 864 (Del. Ch. 1999) (Steele, V.C.) (“[A] fiduciary is typically one who is entrusted with the power to manage and control the property of another.”); *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998) (“An underlying premise for the imposition of fiduciary duties is a separation of legal control from beneficial ownership. Equitable principles act in those circumstances to protect the beneficiaries who are not in a position to protect themselves.” (citation omitted)); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1402 (2002) (“[F]iduciary relationships form when one party (the ‘fiduciary’) acts on behalf of another party (the ‘beneficiary’) while exercising discretion with respect to a critical resource belonging to the beneficiary.”); Julian Velasco, *Fiduciary Duties and Fiduciary Outs*, 21 GEO. MASON L. REV. 157, 159 (2013) (“A fiduciary relationship is a legally recognized relationship in which one is given power over the interests of another, who thereby becomes vulnerable to abuse.”).

33. See *Sokol Holdings*, 2009 WL 2501542, at *3 (“[A]rrangements typically giving rise to fiduciary relationships include trusts, corporations, partnerships, and estates.”); *McMahon v. New Castle Assocs.*, 532 A.2d 601, 604-05 (Del. Ch. 1987) (“Our law has acknowledged several [fiduciary] relationships beyond that of express trustee and corporate officer or director: general partners; administrators or executors; guardians and, in some instances, joint venturers or principals and their agents.” (citations omitted)); see also *In re USACafes, L.P. Litig.*, 600 A.2d 43, 48 (Del. Ch. 1991) (Allen, C.) (“The law of trusts represents the earliest and fullest expression of [the fiduciary] principle in our law, but courts of equity have extended it appropriately to achieve substantial justice in a wide array of situations.”).

34. *Cheese Shop Int’l, Inc. v. Steele*, 303 A.2d 689, 690 (Del. Ch. 1973), *rev’d on other grounds*, 311 A.2d 870 (Del. 1973).

35. *Id.*

control carelessly or exploitatively, in their own self-interest.³⁶ To protect against this vulnerability, equity recognizes a fiduciary duty of care and loyalty owed by those vested with the legal right of control over the property of another.³⁷ Applying the fiduciary principle in the context of business associations, equity ensures that those vested with legal control of a business do not opportunistically exploit that control to benefit themselves at the expense of the business or its true owners.³⁸

B. *Fiduciary Duties in LLCs*

As compared to partnerships and corporations, LLCs are a relatively new form of business association.³⁹ Indeed, Delaware did not adopt its

36. See Smith, *supra* note 32, at 1482-83 (explaining that the rationale for fiduciary duties is to protect the beneficiary from opportunism that arises from the discretionary power wielded by the fiduciary); Velasco, *supra* note 32, at 159 (“[T]he *raison d’être* of fiduciary duties, and of the designation of relationships as fiduciary, is the protection of the beneficiary from abuse at the hands of the fiduciary.”).

37. As Chancellor Allen has explained,

[T]he principle of fiduciary duty, stated most generally, [is] that one who controls property of another may not, without implied or express agreement, intentionally use that property in a way that benefits the holder of the control to the detriment of the property or its beneficial owner. There are, of course, other aspects—a fiduciary may not waste property even if no self interest is involved and must exercise care even when his heart is pure—but the central aspect of the relationship is, undoubtedly, fidelity in the control of property for the benefit of another.

USACafes, 600 A.2d at 48. Elsewhere, Chancellor Allen has also explained the equitable origins of fiduciary duties:

The classic example—the accountability of trustees—demonstrates the reason why chancery takes jurisdiction over fiduciaries. The “fiduciary” duty of a trustee to deal with the trust *res* only for the benefit of the *cestui que trust* and not for his own benefit is a creation of equity. At law a trustee, as the legal owner, may deal with trust property as his own. The rights of a beneficiary are only recognized in equity. Accordingly, an action predicated upon such rights is properly maintained in a court of equity and only a court of equity. A similar rationale underlies Chancery’s traditional jurisdiction over corporate officers and directors. The duties they owe to shareholders with respect to the exercise of their legal power over corporate property supervene their legal rights.

McMahon, 532 A.2d at 604 (citations omitted).

38. See *Crosse v. BCBS, Inc.*, 836 A.2d 492, 495 (Del. 2003) (“This Court has held that ‘the concept of a fiduciary relationship . . . applie[s] in legal relationships where the interests of the fiduciary and the beneficiary incline toward a common goal in which the fiduciary is required to pursue solely the interests of the beneficiary’” (quoting *Corrado Bros. v. Twin City Fire Ins. Co.*, 562 A.2d 1188, 1192 (Del.1989))); *Sokol Holdings*, 2009 WL 2501542, at *3 (Strine, V.C.) (“The reason Chancery has jurisdiction in such cases is because traditionally only the rights of the legal owner are recognized at law, and equity is left to protect the rights of the beneficial owner.”).

39. See generally William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855 (1995) (providing a historical account of the LLC business

LLC statute until 1992⁴⁰—well after the equitable doctrine of fiduciary duty was established in other business contexts. But Delaware’s LLC statute has always contemplated that “[i]n any case not provided for [by the statute], the rules of law and equity . . . shall govern.”⁴¹

Accordingly, analogizing to other, more established business forms, Delaware courts have readily adapted existing equitable principles to LLCs.⁴² With respect to fiduciary duties specifically, even though the Delaware LLC statute does not affirmatively impose such duties on any party,⁴³ the chancery court had little trouble recognizing that those vested with control and discretionary power over an LLC “easily fit[] the definition of a fiduciary”⁴⁴ and, therefore, owe traditional fiduciary duties.⁴⁵

form); Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459 (1998) (same).

40. See Limited Liability Company Act, 68 Del. Laws 1329 (1992) (codified as amended at DEL. CODE ANN. tit. 6, §§ 18-101 to -1109 (2016)); see also Hamill, *supra* note 39, at 1475-76.

41. § 18-1104.

42. See, e.g., *Auriga Capital Corp. v. Gatz Props., LLC*, 40 A.3d 839, 850-51, 855 n.65 (Del. Ch. 2012) (Strine, C.) (analogizing the fiduciary duties owed in the corporate context to the fiduciary duties owed in a manager-managed LLC); *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 662 (Del. Ch. 2012) (Laster, V.C.) (analogizing the fiduciary duties owed in the limited partnership context to the fiduciary duties owed by the managing member of a member-managed LLC); *In re Atlas Energy Res., LLC*, No. 4589-VCN, 2010 WL 4273122, at *7-11 (Del. Ch. Oct. 28, 2010) (Noble, V.C.) (analogizing the fiduciary duties owed by a controlling shareholder in the corporate context to the fiduciary duties owed by a controlling unitholder of an LLC); *Kelly v. Blum*, No. 4516-VCP, 2010 WL 629850, at *11 n.73 (Del. Ch. Feb. 24, 2010) (Parsons, V.C.) (observing in the context of determining the fiduciary duties owed in a manager-managed LLC that “[m]anager-managed LLCs are, in many ways, analogous to corporations, whereas member-managed LLCs may be more analogous to a partnership”); *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, No. 3658-VCS, 2009 WL 1124451, at *9 n.43 (Del. Ch. Apr. 20, 2009) (Strine, V.C.) (observing in the context of determining the fiduciary duties owed by the managing member of a member-managed LLC that “in the absence of developed LLC case law, this court has often decided LLC cases by looking to analogous provisions in limited partnership law”); *Haley v. Talcott*, 864 A.2d 86, 94 (Del. Ch. 2004) (Strine, C.) (analogizing judicial dissolution under DGCL 273 in the corporate context to judicial dissolution of an LLC). See generally *Obeid v. Hogan*, No. 11900-VCL, 2016 WL 3356851, at *5-6 (Del. Ch. June 10, 2016) (discussing the judicial practice and propriety of analogizing LLCs to general and limited partnerships and to corporations).

43. *Auriga*, 40 A.3d at 849 (“The Delaware LLC Act does not plainly state that the traditional fiduciary duties . . . apply by default as to managers or members of a [LLC].”); see also ROBERT L. SYMONDS, JR. & MATTHEW J. O’TOOLE, SYMONDS & O’TOOLE ON DELAWARE LIMITED LIABILITY COMPANIES § 9.04[B][3] (2d ed. 2015) (The statute leaves “such matters [i.e. fiduciary duties] to [the] development in the Delaware case law.”).

44. *Auriga*, 40 A.3d at 850; accord *id.* at 854 (“[M]anagers of LLCs easily qualify as fiduciaries under traditional and settled principles of equity”); see also *Feeley*, 62 A.3d at 661 (Laster, V.C.) (“The managing member of an LLC ‘is vested with discretionary power to manage the business of the LLC’ and ‘easily fits the definition of a fiduciary.’” (quoting *Auriga*, 40 A.3d at 850-51)).

45. See, e.g., *Auriga*, 40 A.3d at 851 (Strine, C.) (“[B]ecause the LLC Act provides for principles of equity to apply, because LLC managers are clearly fiduciaries, and because fiduciaries owe the fiduciary duties of loyalty and care, the LLC Act starts with the default

As Delaware Chief Justice Strine explained in *Auriga Capital v. Gatz Properties*,⁴⁶ sitting then as the Chancellor:

It seems obvious that, under traditional principles of equity, a manager of an LLC would qualify as a fiduciary . . . [.] “[A] fiduciary relationship is a situation where one person reposes special trust in and reliance on the judgment of another or where a special duty exists on the part of one person to protect the interests of another.” Corporate directors, general partners and trustees are analogous examples of those who . . . owe a “special duty.” Equity distinguishes fiduciary relationships from straightforward commercial arrangements where there is no expectation that one party will act in the interests of the other. . . . The manager of an LLC has more than an arms-length, contractual relationship with the members of the LLC. Rather, the manager is vested with discretionary power to manage the business of the LLC.⁴⁷

Therefore, the then-chancellor concluded, “because LLC managers are clearly fiduciaries, . . . the LLC Act starts with the default that managers of LLCs owe enforceable fiduciary duties.”⁴⁸

C. *Freedom of Contract and the Limits on Equity*

Although Delaware law has imported traditional equitable principles, including fiduciary duties, into the LLC context, Delaware’s LLC statute also makes clear that those equitable principles are subordinate to the “freedom of contract and to the enforceability of [LLC]

that managers of LLCs owe enforceable fiduciary duties.”); *Feeley*, 62 A.3d at 661 (Laster, V.C.) (“[The] Delaware [LLC Act] contemplates that equitable fiduciary duties will apply by default to a manager or managing member of a Delaware LLC.”); *Phillips v. Hove*, No. 3644-VCL, 2011 WL 4404034, at *24 (Del. Ch. Sept. 22, 2011) (Laster, V.C.) (“Unless limited or eliminated in the entity’s operating agreement, the member-managers of a Delaware [LLC] owe traditional fiduciary duties to the LLC and its members.”); *Atlas Energy*, 2010 WL 4273122, at *6 (Noble, V.C.) (“[I]n the absence of explicit provisions in a [LLC] agreement to the contrary, the traditional fiduciary duties owed by corporate directors and controlling shareholders apply in the [LLC] context.”); *Kelly*, 2010 WL 629850, at *10 (Parsons, V.C.) (“[U]nless the LLC agreement in a manager-managed LLC explicitly expands, restricts, or eliminates traditional fiduciary duties, managers owe those duties to the LLC and its members and controlling members owe those duties to minority members.”); *Bay Ctr.*, 2009 WL 1124451, at *8 (Strine, V.C.) (holding that “in the absence of a contrary provision in the LLC agreement, the manager of an LLC owes the traditional fiduciary duties of loyalty and care to the members of the LLC”).

46. *Auriga Capital Corp. v. Gatz Props., LLC*, 40 A.3d 839, 849 (Del. Ch. 2012), *aff’d sub nom.* *Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206 (Del. 2012).

47. *Id.* at 850-51 (footnote omitted); *accord id.* at 855-56 n.65 (“[M]anagers of LLCs owe fiduciary duties because they fit within the classic definition of a fiduciary of a business enterprise under traditional principles of equity.”); *see also Feeley*, 62 A.3d at 661-63 (Laster, V.C.) (holding that those who have discretionary power and control over an LLC owe traditional fiduciary duties in the absence of an agreement to the contrary).

48. *Auriga*, 40 A.3d at 851.

agreements.”⁴⁹ This freedom of contract includes the freedom to privately order all aspects of an LLC’s internal governance,⁵⁰ including the fiduciary duties that might otherwise apply to those vested with control over the business.⁵¹ To emphasize this point, the LLC statute provides that:

To the extent that, at law or in equity, a member or manager or other person has duties (*including fiduciary duties*) to a [LLC] or to another member . . . , the member’s or manager’s or other person’s duties may be *expanded or restricted or eliminated* by provisions in the [LLC] agreement⁵²

Thus, while fiduciary duties are generally mandatory under corporate law—a corporate charter cannot eliminate the fiduciary duties of its officers and directors⁵³—these duties are simply default rules for

49. DEL. CODE ANN. tit. 6, § 18-1101(b) (2016).

50. See *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 290 (Del. 1999) (“The [LLC] Act can be characterized as a ‘flexible statute’ because it generally permits members to engage in private ordering with substantial freedom of contract to govern their relationship” (quoting 1 JAMES D. COX ET AL., CORPORATIONS, § 1.12, at 1.37-38 (1999))).

51. See Manesh, *Market for LLC Law*, *supra* note 2, at 225-34 (discussing the freedom of contract permitted under LLC law regarding fiduciary duties).

52. § 18-1101(c) (emphasis added).

53. As I have elaborated elsewhere:

At most, corporations may eliminate managerial liability arising from breaches of the fiduciary duty of care and carve out limited exceptions to the corporate opportunity doctrine. Corporations cannot eliminate the substantive obligations of the fiduciary duty of care; cannot eliminate the substantive obligations of the fiduciary duty of loyalty or any liability arising from the breach of that duty; cannot eliminate the corporate opportunity doctrine altogether; cannot insulate all interested transactions from exacting entire fairness review; cannot eliminate so-called *Revlon* duties; and cannot protect managerial decisions from judicial scrutiny under the intermediate *Unocal* standard of review. Delaware alternative entities [including LLCs], however, can do all of these things.

Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. CORP. L. 555, 561-62 (2012) [hereinafter Manesh, *Contractual Freedom*] (footnotes omitted); see also Mohsen Manesh, *Legal Asymmetry and the End of Corporate Law*, 34 DEL. J. CORP. L. 465 (2009) [hereinafter Manesh, *Legal Asymmetry*] (questioning this dichotomy in corporate versus alternative entity law in the context of publicly traded LLCs and limited partnerships).

LLCs.⁵⁴ Fiduciary duties will apply only in the absence of terms in an LLC agreement modifying or eliminating such duties.⁵⁵

This freedom of contract extends not only to fiduciary duties, but also to other equitable principles that would ordinarily apply to LLCs. For example, Delaware's LLC statute recognizes the standing of LLC members to bring a derivative suit on behalf of an LLC,⁵⁶ but the Delaware Supreme Court has held that the statutorily mandated freedom of contract includes the freedom to eliminate the derivative standing of members.⁵⁷ Likewise, although the Delaware LLC statute recognizes the right of LLC members to seek judicial dissolution "whenever it is not reasonably practicable to carry on the business" of the LLC,⁵⁸ the chancery court has held that this right to judicial dissolution may be waived in the terms of an LLC agreement.⁵⁹

As a consequence, Delaware LLC law enables parties to draft agreements that substantially constrain the role of equity in LLCs. In this respect, Delaware LLC law stands in stark contrast to not only its corporate law,⁶⁰ but also the LLC law of other states, in particular those that have adopted the Uniform Limited Liability Company Act

54. See, e.g., *Kelly v. Blum*, No. 4516-VCP, 2010 WL 629850, at *11 (Del. Ch. Feb. 24, 2010) (noting that while Delaware's corporate statute "authorizes a corporation to adopt provisions limiting liability for a director's breach of the duty of care, [Delaware's LLC statute] goes further by allowing broad exculpation of *all* liabilities for breach of fiduciary duties—including the duty of loyalty" (footnote omitted)); *Sutherland v. Sutherland*, No. 2399-VCL, 2009 WL 857468, at *4 (Del. Ch. Mar. 23, 2009) (noting that "[w]hile such a provision [limiting the fiduciary duty of loyalty] is permissible under the Delaware [LLC] Act and the Delaware Revised Uniform Limited Partnership Act, where freedom of contract is the guiding and overriding principle, it is expressly forbidden by the [Delaware corporate statute]").

55. See *Manesh, Contractual Freedom*, *supra* note 53, at 568-69 (describing how an LLC or limited partnership agreement may eliminate fiduciary duties wholesale or modify only limited aspects of fiduciary duties by including terms inconsistent with the application of such duties); see also cases cited *supra* note 45 (holding that fiduciary duties apply as a default in LLCs in the absence of provisions in an LLC agreement to the contrary).

56. See DEL. CODE ANN. tit. 6, § 18-1001 (2016).

57. See *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 295 (Del. 1999) ("We hold that, because the policy of the Act is to give the maximum effect to the principle of freedom of contract and to the enforceability of LLC agreements, the parties may contract to avoid the applicability of Section[] . . . 18-1001[which codifies the derivative standing of LLC members].").

58. See § 18-802.

59. See *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at *4-6 (Del. Ch. Aug. 19, 2008).

60. See *supra* notes 53-54 and accompanying text.

(ULLCA)⁶¹ or the increasingly popular Revised Uniform Limited Liability Company Act (RULLCA).⁶² Under both the ULLCA and RULLCA, the ability of parties to contractually tailor fiduciary duties is statutorily limited.⁶³ Generally, an LLC agreement under either uniform statute cannot lawfully place “manifestly unreasonable” restrictions on the fiduciary duty of loyalty or care.⁶⁴ Indeed, the uniform LLC statutes identify a number of mandatory provisions that cannot be eliminated by the terms of an LLC agreement.⁶⁵ These mandatory provisions include the rights of LLC members to bring a derivative lawsuit on behalf of the LLC,⁶⁶ as well as the right to seek judicial dissolution.⁶⁷

As result of these statutory differences, courts in jurisdictions governed by statutes following the ULLCA or RULLCA retain significant equitable discretion to ensure fairness and justice in LLC cases through the application of the uniform statutes’ mandatory standards like “manifestly unreasonable.”⁶⁸ By contrast, in Delaware, where an LLC agreement waives or displaces traditional equitable principles, the courts have found themselves robotically enforcing the terms of the agreement, without ever seriously questioning whether such enforcement is fair, reasonable, or just given the circumstances presented.⁶⁹ Perhaps nowhere is this contrast more vivid than in cases involving alleged breaches of the fiduciary duty of loyalty. Where those vested

61. UNIF. LTD. LIAB. CO. ACT (UNIF. LAW COMM’N 1996) [hereinafter ULLCA], <http://www.uniformlaws.org/shared/docs/limited%20liability%20company/ullca96.pdf> [<http://perma.cc/27TP-2ATY>].

62. REVISED UNIF. LTD. LIAB. CO. ACT (UNIF. LAW COMM’N 2006) [hereinafter RULLCA], http://www.uniformlaws.org/shared/docs/limited%20liability%20company/ullca_final_06rev.pdf [<https://perma.cc/Q8H6-DK8C>].

63. See ULLCA § 103(b)(2)-(3); RULLCA § 110(d).

64. The ULLCA actually treats the two fiduciary duties slightly differently. Under the ULLCA, LLC agreements cannot place “manifestly unreasonable” restrictions on the fiduciary duty of loyalty or “unreasonably reduce” the fiduciary duty of care. See ULLCA § 103(b)(2) (addressing loyalty); *id.* § 103(b)(3) (addressing care). The RULLCA addresses both fiduciary duties with the same legal standard. The RULLCA provides LLC agreements cannot impose “manifestly unreasonable” limitations on either fiduciary duty of loyalty or care. See RULLCA § 110(d); see also Mark J. Loewenstein, *Fiduciary Duties and Unincorporated Business Entities: In Defense of the “Manifestly Unreasonable” Standard*, 41 TULSA L. REV. 411, 431-34 (2006) (explaining the “manifestly unreasonable” standard).

65. See ULLCA § 103(b); RULLCA § 110(c).

66. See RULLCA § 110(c)(9). The ULLCA does not have a similar provision. See ULLCA § 103(b).

67. See ULLCA § 103(b)(6); RULLCA § 110(c)(7).

68. See Loewenstein, *supra* note 64, at 440 (conceding that the “manifestly unreasonable” standard “is indeed uncertain, ambiguous, nebulous, and . . . [lacks] clearly defined limits”). Other mandatory provisions of the uniform LLC statutes likewise reserve room for the exercise of a court’s equitable discretion, including the standards of “oppressive” or “not reasonably practicable to carry on” the LLC’s business, either of which may serve as a basis for triggering judicial dissolution. See RULLCA §§ 110(c)(7), 701(a)(4)-(5).

69. See *supra* note 6.

with legal control over the LLC have engaged in bad faith conduct or self-dealing at the expense of the business or its owners, Delaware's LLC statute and case law suggest that, in deference to the freedom of contract, the courts are powerless to do equity in the face of an LLC agreement waiving or displacing traditional fiduciary duties. It is this basic understanding of LLC law—the supremacy of contract over equity—that *Carlisle* subverts.

III. THE CONSTITUTIONAL CASE FOR EQUITY

Despite Delaware's unequivocal embrace of freedom of contract in statute and case law, the role of equity in LLCs is not as settled as it might seem. Lurking in Delaware's state constitution, there is a strong argument to be made that courts are not left powerless to do equity, even when presented with an LLC agreement that purports to eliminate fiduciary duties or curb other traditionally equitable principles. Section A explains this argument. And Section B describes how the Delaware courts have responded to it. As Section B explains, the Delaware courts have now twice addressed the constitutional basis for equity in LLCs. But those two cases—*Bax* and *Carlisle*—reached opposite conclusions on the constitutional issue. Consequently, today, the role of equity in LLC law remains unsettled.

A. *Equity Jurisdiction Under the Delaware Constitution*

The constitutional case for equity in LLCs was first voiced in a 2011 article by Professor Lyman Johnson.⁷⁰ In short, Johnson argued the Delaware Chancery Court's equitable powers are constitutionally protected and, therefore, cannot be reduced by legislative statute or private agreement.⁷¹

Johnson's argument is based on the Delaware Supreme Court's interpretation of Article IV, Section 10 of the state's current constitution.⁷² That section provides, in relevant part, that the Delaware Chancery Court "shall have all the jurisdiction and powers vested by the laws of this State in the Court of Chancery."⁷³ This language traces its origins back to the Delaware Constitution of 1792, which was the first time the state constitutionalized the jurisdiction of its chancery court.⁷⁴ Interpreting this language in light of its complex history, the Delaware Supreme Court held in *DuPont v. DuPont* that

70. See generally Johnson, *supra* note 22, at 701-03.

71. See *id.* at 702-03.

72. See *id.* at 716-18; see also DEL. CONST. art. IV, § 10.

73. DEL. CONST. art. IV, § 10.

74. See *DuPont v. Dupont*, 85 A.2d 724, 728 (Del. 1951).

the state constitution vests the Delaware Chancery Court with equitable jurisdiction equivalent to that of the High Court of Chancery in Great Britain at the time of the separation of the American colonies.⁷⁵ More importantly, the supreme court also held that the state legislature is constitutionally prohibited from restricting the chancery court's equity jurisdiction to less than this "irreducible minimum" as first set in 1792.⁷⁶

But, as Johnson argues, Delaware's LLC statute purports to do just that.⁷⁷ The doctrine of fiduciary duty was well established in equity at the time of this nation's founding.⁷⁸ Therefore, Johnson concludes, "under the reasoning of *DuPont*, the [Delaware] Chancery Court's jurisdiction over fiduciary duty claims [can]not be divested through legislation enacted by the Delaware General Assembly."⁷⁹ To be sure, Delaware's LLC statute does not directly purport to divest the chancery court's equity jurisdiction to recognize and enforce fiduciary claims. But it does so indirectly. By purporting to authorize contractual restrictions or elimination of fiduciary duties,⁸⁰ the state legislature attempts to empower private individuals to do what the legislature cannot do directly.⁸¹ "In effect, the General Assembly is aggrandizing to itself, and private parties, the power to decide what the Delaware judiciary can and cannot do" with respect to fiduciary relationships.⁸²

75. See *id.* at 728-30; see also Quillen & Hanrahan, *supra* note 1, at 849 (summarizing the holding of *Dupont*).

76. See *Dupont*, 85 A.2d at 729 (holding that "the general equity jurisdiction of the Court of Chancery is measured in terms of the general equity jurisdiction of the High Court of Chancery of Great Britain and is a constitutional grant not subject to legislative curtailment . . ."); *id.* (interpreting the state constitution "to establish . . . the irreducible minimum of the judiciary. . . [.] secur[ing] for the protection of the people an adequate judicial system and remov[ing] it from the vagaries of legislative whim"); *accord* CML V, LLC v. Bax, 28 A.3d 1037, 1044 (Del. 2011) ("The Delaware Constitution prohibits the General Assembly from limiting the equity jurisdiction of the Court of Chancery to less than the general equity jurisdiction of the High Court of Chancery of Great Britain existing at the time of our separation from the Mother Country." (citing *Dupont*, 85 A.2d 724); *In re Carlisle Etcetera LLC*, 114 A.3d 592, 602 (Del. Ch. 2015) (paraphrasing *Dupont's* holding that the state constitution "vested in the Court of Chancery 'all the general equity jurisdiction of the High Court of Chancery of Great Britain as it existed prior to the separation of the colonies . . .' [and that] the General Assembly cannot enact legislation that reduces this court's jurisdiction below the constitutionally established minimum . . ." (quoting *DuPont*, 85 A.2d at 727)).

77. See Johnson, *supra* note 22, at 711-18.

78. See *id.* at 711-12, 718 (citing *Charitable Corp. v. Sutton* (1742) 26 Eng. Rep. 642 (Ch.)).

79. *Id.* at 718 (footnote omitted).

80. DEL. CODE ANN. tit. 6, § 18-1101(c) (2016).

81. See Johnson, *supra* note 22, at 713-14. To be sure, there is nothing to suggest that in enacting this provision of the LLC statute, the Delaware General Assembly understood and intended to circumvent the constitutional limits on its legislative power. Rather, in enacting the provision, the General Assembly appears to have unknowingly superseded its constitutional authority regarding equity jurisdiction.

82. *Id.* at 714.

The upshot of Johnson's analysis is that, despite Delaware's embrace of freedom of contract, as a constitutional matter, Delaware courts retain their traditional equitable power to recognize fiduciary relationships and impose fiduciary standards.⁸³ That power means that Delaware courts need not blithely defer to terms in an LLC agreement purporting to limit or eliminate fiduciary duties.⁸⁴ Instead, the chancery court must, in each case, ascertain, as an equitable matter, whether to enforce the terms of an LLC agreement given the circumstances with which it is presented.⁸⁵

Although Johnson's article centers on the enforceability of fiduciary waivers,⁸⁶ his analysis has the same force anytime the LLC statute or an agreement purports to limit or eliminate a facet of the chancery court's traditional equitable powers. So, it is interesting that in the two LLC cases where the Delaware courts have addressed the scope of the chancery court's constitutionally protected equity jurisdiction, the courts were focused on other, non-fiduciary facets of that jurisdiction: derivative standing and judicial dissolution.

B. Divergent Judicial Views

Prior to the publication of Johnson's 2011 article, no Delaware court had ever considered the implications of the chancery court's constitutionally protected equity jurisdiction as applied to LLCs—presumably because no litigant had previously raised the issue. But immediately after his article's publication, the plaintiff in *CML V, LLC v. Bax*⁸⁷ made the constitutional argument for the first time on appeal before the Delaware Supreme Court.⁸⁸

I. Bax

In *Bax*, the Delaware Supreme Court was faced with a narrow legal question: whether the state's LLC statute precludes derivative standing for an LLC creditor. The plaintiff in *Bax*, a junior secured creditor of an insolvent LLC, sought to bring a derivative suit on behalf of the

83. See *id.* at 718.

84. See *id.* at 718-19.

85. See *id.* (arguing that, despite the authorization of fiduciary waivers in the LLC statute, the chancery court retains the "continuing responsibility to ask—in every case—whether, in equity, [the court] should or should not enforce the contractual waiver").

86. Although Johnson limits the scope of his analysis to fiduciary waivers, he does apply it beyond the specific context of LLCs to include fiduciary waivers in general partnership and limited partnership agreements. See, e.g., Johnson, *supra* note 22, at 706-07, 719.

87. 28 A.3d 1037 (Del. 2011).

88. At the chancery court, the plaintiff did not raise, and the court did not consider, the potential constitutional issue implicated by the derivative standing provision in the LLC statute. See *CML V, LLC v. Bax*, 6 A.3d 238 (Del. Ch. 2010).

LLC against the LLC's officers for breaching their fiduciary duties owed to the LLC.⁸⁹ As a result of these breaches, the plaintiff-creditor asserted, the LLC was forced into liquidation and, ultimately, failed to repay the debt owed to the plaintiff.⁹⁰

The defendant-officers sought to dismiss the plaintiff's derivative claims, arguing that the plaintiff-creditor lacked standing under Delaware's LLC statute to bring a lawsuit on behalf of the LLC.⁹¹ Specifically, the LLC statute provides that in a derivative action, "the plaintiff *must be a member or an assignee* of a [LLC] interest at the time of bringing the action."⁹² This statutory language, the defendants contended, precluded the court from recognizing derivative standing for any other parties, including LLC creditors like the plaintiff.⁹³

The plaintiff countered that such a literal interpretation of the LLC statute—limiting derivative standing exclusively to LLC members and assignees—would render the statute unconstitutional under the state constitution because the statute would divest the chancery court of its traditional equitable power to recognize derivative standing for other parties where justice required it.⁹⁴ To make this point, the plaintiff-creditor pointed to Delaware corporate law precedent.⁹⁵ Delaware's corporate statute recognizes the right of only stockholders to bring a "derivative suit";⁹⁶ yet Delaware courts have also extended derivative standing to non-stockholder creditors when a corporation becomes insolvent.⁹⁷ This right of non-stockholder creditors to bring a derivative action stems not from any provision in Delaware's corporate statute, but from the courts' equitable power. As the Delaware Supreme Court explained in a decision prior to *Bax*, a "corporation's insolvency 'makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value.' Therefore, equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation" to prevent failures of justice.⁹⁸

89. See *Bax*, 28 A.3d at 1039-40.

90. See *id.*

91. See *id.* at 1040.

92. DEL. CODE ANN. tit. 6, § 18-1002 (2016) (emphasis added).

93. See *Bax*, 28 A.3d at 1040.

94. See *id.* at 1043-44.

95. See *id.* at 1042.

96. tit. 8, § 327 (2016).

97. See *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) ("[T]he creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties.").

98. *Id.* at 101-02 (quoting *Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 794 n.67 (Del. Ch. 2004)).

In *Bax*, however, the Delaware Supreme Court sidestepped any potential constitutional problem by rejecting the notion that equity plays a similar role in the LLC context.⁹⁹ To support this conclusion, the high court sharply distinguished LLCs from corporations. The court acknowledged that at the time of this nation's independence, the equitable right of a corporation's stockholders to bring a derivative lawsuit on behalf of a corporation was recognized by equity in order to prevent failures of justice.¹⁰⁰ And because derivative standing is itself an equitable doctrine, the court agreed that the doctrine may be extended as equity requires to address new circumstances,¹⁰¹ as was the case involving the creditors of an insolvent corporation.¹⁰² Therefore, the court conceded, citing *Dupont*, "the Delaware Constitution prohibits the General Assembly from limiting the Court of Chancery's jurisdiction over the extension of corporate derivative standing."¹⁰³

Importantly, however, the court observed, the plaintiff's claim involved an LLC, not a corporation. Unlike corporations, LLCs did not exist at the time of the American colonies' separation from Britain.¹⁰⁴ "The corporate form existed in 1792, but LLCs came into existence in Delaware in 1992" when Delaware first adopted its LLC statute.¹⁰⁵ Therefore, the court ruled, LLCs fall outside of the chancery court's constitutionally vested equity jurisdiction.¹⁰⁶ As a result, any rights, remedies, or obligations associated with LLCs, including the right of derivative standing asserted by the plaintiff, must arise not in equity, but from the LLC statute or the agreement governing the LLC.¹⁰⁷

By placing LLCs beyond the chancery court's equitable powers, *Bax* avoided any potential constitutional issues raised by the LLC statute. Because LLCs did not exist at the time of this nation's founding, "nothing in the Delaware Constitution precludes the General Assembly from limiting the scope of LLC derivative standing."¹⁰⁸ Less than four

99. See *Bax*, 28 A.3d at 1044-46.

100. See *id.* at 1044; see also *Schoon v. Smith*, 953 A.2d 196, 201 (Del. 2008) (discussing the history of derivative standing in equity).

101. See *Bax*, 28 A.3d at 1044.

102. See *supra* notes 97-98 and accompanying text.

103. See *Bax*, 28 A.3d at 1045.

104. See *id.* ("[T]his case deals not with a corporation but with a statutorily created LLC—a business entity that did not exist in 1792.").

105. *Id.*

106. See *id.* (holding that because LLCs are "a business entity that did not exist in 1792[.] . . . nothing in the Delaware Constitution precludes the General Assembly from limiting the scope of [the equitable doctrine of] . . . derivative standing" in LLCs).

107. See *id.* ("[W]hen adjudicating the rights, remedies, and obligations associated with Delaware LLCs, courts must look to the LLC Act because it is *only the statute* that creates those rights, remedies, and obligations." (emphasis added)).

108. *Id.*

years later, the chancery court in *In re Carlisle Etcetera LLC* reached a starkly different conclusion on the constitutional question.

2. Carlisle

As in *Bax*, the court in *Carlisle* faced a relatively narrow legal question: whether the state's LLC statute precludes a non-member assignee of an LLC interest from seeking judicial dissolution of an LLC. In *Carlisle*, the assignee of an LLC interest had petitioned the court for judicial dissolution of the LLC, alleging the LLC's "board of directors," who collectively acted as the LLC's manager, were irresolvably deadlocked on all key decisions.¹⁰⁹ Initially formed as a two-member LLC, one of the two members had since assigned its LLC interest to a wholly-owned subsidiary.¹¹⁰ As a result of that assignment, the assignor lost its status as a member.¹¹¹ More consequentially, because the assignee-subsi-diary was never admitted as a member by formal action of the remaining LLC member in the manner dictated by statute,¹¹² the subsidiary became a mere assignee of an LLC interest and not a member.¹¹³

As noted previously,¹¹⁴ Delaware's LLC statute explicitly authorizes the judicial dissolution of an LLC upon irresolvable deadlock "when-ever it is not reasonably practicable to carry on the business [of the LLC] in conformity with a [LLC] agreement."¹¹⁵ Importantly, however, judicial dissolution is only permitted under the statute "[o]n applica-tion *by or for a member or manager*."¹¹⁶ Seizing on this statutory language, the sole remaining LLC member sought to dismiss the peti-tion for judicial dissolution, arguing that the petition was brought by an assignee and not "a member or manager" as statutorily required.¹¹⁷

The chancery court, per Vice Chancellor Laster, agreed with the LLC's sole remaining member that the assignee could not petition for judicial dissolution under the LLC statutory text.¹¹⁸ Nonetheless, the

109. See *In re Carlisle Etcetera LLC*, 114 A.3d 592, 594 (Del. Ch. 2015).

110. See *id.* at 594-96.

111. See *id.* at 598; see also DEL. CODE ANN. tit. 6, § 18-702(b)(3) (2016) ("A member ceases to be a member and to have the power to exercise any rights or powers of a member upon assignment of all of the member's [LLC] interest.").

112. § 18-702(a) ("The assignee of a member's [LLC] interest shall have no right to partici-pate in the management of the business and affairs of a [LLC] except . . . upon the vote or consent of all of the members of the [LLC].").

113. See *Carlisle*, 114 A.3d at 598-601.

114. See *supra* note 58 and accompanying text.

115. § 18-802.

116. *Id.* (emphasis added).

117. *Carlisle*, 114 A.3d at 597.

118. *Id.* at 601.

vice chancellor ruled the assignee could seek judicial dissolution as an equitable matter.¹¹⁹

To support this conclusion, the vice chancellor began by observing that the judicial power to order dissolution of a solvent business is itself a power that originated in equity.¹²⁰ Therefore, the vice chancellor reasoned, as a constitutional matter, the LLC statute cannot limit the court's traditional equitable power to order dissolution in circumstances where justice dictated.¹²¹ If the LLC statute were interpreted otherwise, to "provide the exclusive method of dissolving an LLC," then it "would raise serious constitutional questions" because the statute would unconstitutionally "divest this court of a significant aspect of its traditional equitable jurisdiction."¹²²

By holding that the court's constitutionally vested equitable power to order dissolution extends to LLCs, the vice chancellor recognized the tension created with *Bax*.¹²³ After all, in *Bax*, the supreme court asserted that LLCs are not subject to the chancery's traditional equitable powers.¹²⁴ Under *Bax*, the only rights of an LLC party are those that arise under the LLC statute or governing contract, not in equity.¹²⁵ To address that tension, the vice chancellor baldly refuted what he described as *Bax*'s "radical form of constitutional originalism"¹²⁶:

Although this court's equitable jurisdiction is measured by the "the general equity jurisdiction of the High Court of Chancery of Great Britain as it existed prior to the separation of the colonies," the Delaware Supreme Court has [in decisions prior to *Bax*] recognized that the scope of that jurisdiction is not limited by the extent of British

119. *Id.*

120. *Id.*

121. *Id.* at 602 ("If [the LLC statutory provision] did purport to establish an exclusive means to obtain dissolution and override a significant portion of this court's traditional equitable jurisdiction, then the validity of that aspect of the provision would raise serious constitutional questions.").

122. *Id.* at 601-02; see also Jason C. Jowers & Meghan A. Adams, *The Increasing Role of Equity in Delaware LLC Litigation*, 2015 BUS. L. TODAY 1, 3 ("According to the court [in *Carlisle*], if [the LLC statute] could be interpreted to be the exclusive method of judicial dissolution, it would likely violate the Delaware Constitution.").

123. See *Carlisle*, 114 A.3d at 603 n.3 (citing *Bax* as conflicting precedent).

124. See *CML V, LLC v. Bax*, 28 A.3d 1037, 1045 (Del. 2011) (holding that because LLCs are "a business entity that did not exist in 1792[,] . . . nothing in the Delaware Constitution precludes the General Assembly from limiting the scope of LLC derivative standing").

125. See *id.* ("[W]hen adjudicating the rights, remedies, and obligations associated with Delaware LLCs, courts must look to the LLC Act because it is *only the statute* that creates those rights, remedies, and obligations." (emphasis added)).

126. *Carlisle*, 114 A.3d at 603 n.3 ("Excluding LLCs and other post-eighteenth century entities from the domain of equity based on when the governing statutes were adopted would represent a radical form of constitutional originalism that even the strongest judicial proponents of that doctrine have not embraced.").

scientific, technological, and legal knowledge at the time of the handover.

. . . .

It is the “complete system” of equity that this court inherited and administers, not the temporally specific subject matter of eighteenth century cases.¹²⁷

Given these considerations, the vice chancellor concluded: “I cannot accept the contention that because the nascent practice of entity law as it existed at the time of the colonies’ separation had not yet envisioned LLCs, they fall outside the domain of equity.”¹²⁸

3. *Irreconcilable Conflict Between Bax and Carlisle*

Both *Bax* and *Carlisle* agree on *Dupont’s* basic interpretation of the state constitution: The chancery court’s equitable powers are constitutionally vested and cannot be legislatively reduced to less than what those powers were in 1792.¹²⁹ Where the two cases diverge, however, is on the question of whether the constitutionally vested jurisdiction to apply equitable doctrines extends to LLCs and other business forms not yet in existence in 1792.¹³⁰

This divergence is critical. If *Carlisle* is correct that the chancery court’s equity jurisdiction extends to newer business forms, then the Delaware state constitution has far-reaching implications for LLCs. Under the state’s constitution, the chancery court’s traditional equitable powers—including the power to grant derivative standing, order dissolution, or to recognize fiduciary relationships and enforce fiduciary duties—cannot be limited by the LLC statute or a private

127. *Id.* at 602 (internal citations omitted).

128. *Id.* at 603.

129. *See Dupont v. Dupont*, 85 A.2d 724, 729 (Del. 1951); *accord Bax*, 28 A.3d at 1044 (Del. 2011) (“The Delaware Constitution prohibits the General Assembly from limiting the equity jurisdiction of the Court of Chancery to less than the general equity jurisdiction of the High Court of Chancery of Great Britain existing at the time of our separation from the Mother Country.” (citing *Dupont*, 85 A.2d at 729)); *Carlisle*, 114 A.3d at 602 (paraphrasing *Dupont’s* holding to be that the state constitution “vested in the Court of Chancery ‘all the general equity jurisdiction of the High Court of Chancery of Great Britain as it existed prior to the separation of the colonies . . .’ [and] that the General Assembly cannot enact legislation that reduces this court’s jurisdiction below the constitutionally established minimum”).

130. *Compare Bax*, 28 A.3d at 1045 (holding that because LLCs are “a business entity that did not exist in 1792[,] . . . nothing in the Delaware Constitution precludes the General Assembly from limiting the scope of [the equitable doctrine of] derivative standing” in LLCs), *with Carlisle*, 114 A.3d at 603 (“I cannot accept the contention that because the nascent practice of entity law as it existed at the time of the colonies’ separation had not yet envisioned LLCs, they fall outside the domain of equity.”).

agreement authorized by that statute.¹³¹ *Bax* avoids these difficult issues by holding that the chancery court's traditional equitable powers, vested since 1792, are simply frozen in time, inapplicable to LLCs and other newer business entities not yet conceived at the time of this nation's founding.¹³²

Understandably, one might be tempted to distinguish *Carlisle* from *Bax*, in order to avoid the difficult constitutional issues that *Carlisle* raises. But as to the core constitutional question, such attempts are unavailing. For example, one might attempt to reconcile *Carlisle* with *Bax* by distinguishing the specific statutory provisions at issue in each case. The relevant statutory provision in *Bax* was unambiguous that in a derivative action "the plaintiff *must be* a member or an assignee."¹³³ As the high court noted, the word "must" is "mandatory and exclusive," and therefore, the statutory language is "clear [and] unequivocal."¹³⁴ In contrast, the relevant statutory provision in *Carlisle*—authorizing judicial dissolution "[o]n application by or for a member or manager"¹³⁵—did not purport to be exclusive, leaving room for the court to supplement the statute with equitable rights and remedies.¹³⁶

But the problem with distinguishing *Carlisle* from *Bax* based on the statutory language at issue in each case is that the statutory language ignores the underlying constitutional question. The underlying constitutional question is whether the chancery court's equitable powers vested in 1792 apply to LLCs. If so, then the state constitution precludes any legislative attempt to abridge the chancery court's jurisdiction to apply and enforce traditional equitable principles in LLC cases. *Carlisle* and *Bax* come to conflicting conclusions on this basic question.¹³⁷ The relative ambiguity or indefiniteness of the statutory provision has no relevance to the constitutional question.¹³⁸

For similar reasons, one cannot distinguish *Carlisle* from *Bax* by pointing to the relative equitable considerations implicated in each case,

131. See *supra* notes 77-86 and accompanying text.

132. See *Bax*, 28 A.3d at 1045 (holding that because LLCs are "a business entity that did not exist in 1792[,] . . . nothing in the Delaware Constitution precludes the General Assembly from limiting the scope of LLC derivative standing").

133. DEL. CODE ANN. tit. 6, § 18-1002 (2016) (emphasis added).

134. *Bax*, 28 A.3d at 1041-42.

135. § 18-802.

136. See *In re Carlisle Etcetera LLC*, 114 A.3d 592, 601 (Del. Ch. 2015) ("Section 18-802 does not state that it establishes an exclusive means to obtain dissolution, nor does it contain language overriding this court's equitable authority.>").

137. See *supra* note 130.

138. For this reason, the Delaware Supreme Court's assertion in *Bax* that the chancery court's constitutionally vested "equitable power cannot override the LLC Act's express provisions" is illogical. *Bax*, 28 A.3d at 1045-46. If the power is one that is constitutionally protected, then it cannot be legislatively or contractually abrogated.

as Vice Chancellor Laster attempted to do.¹³⁹ In his *Carlisle* opinion, the vice chancellor noted that unlike the LLC creditor in *Bax*, who had ample adequate remedies at law and therefore did not deserve the protection of equity, the assignee of an LLC interest in *Carlisle* was left powerless at law to affect change in the LLC.¹⁴⁰ This point is relevant because, even if LLCs are subject to the chancery court's equity jurisdiction, it is axiomatic that equity will not intervene where there exists an adequate legal remedy.¹⁴¹ But the question of whether there exists an adequate legal remedy in any given case is separate and distinct from the underlying constitutional question of whether the chancery court's

139. See *Carlisle*, 114 A.3d at 604-05.

140. See *id.* (citing *Bax*, 28 A.3d at 1046).

141. See *Chavin v. H.H. Rosin & Co.*, 246 A.2d 921, 922 (Del. 1968) ("It is, of course, axiomatic that Equity has no jurisdiction over a controversy for which there is a complete and adequate remedy at law."); accord *Bax*, 28 A.3d at 1046 ("Even if the Court of Chancery did have the jurisdiction to extend LLC derivative standing . . . it should exercise that jurisdiction only absent an adequate remedy at law."). Although *Chavin*, which is cited by *Bax*, suggests that "equity has no jurisdiction" where there is an adequate remedy at law, this is in fact an example of the type of conflation discussed *infra* note 142, confounding (i) "equity jurisdiction" and (ii) a principle of equity jurisprudence. In fact, for claims asserting purely equitable rights, there exists exclusive equity jurisdiction irrespective of whether there is any adequate remedy at law. See *infra* note 142; see also *Harman v. Masoneilan Int'l, Inc.*, 442 A.2d 487, 498-99, 499 n.22 (Del. 1982) (holding that a claim for breach of fiduciary duty falls within exclusive equity jurisdiction, and therefore, it is irrelevant whether there is an adequate remedy available at law); *Glanding v. Indus. Trust Co.*, 45 A.2d 553, 556 (Del. 1945) (holding that "no positive restriction or limitation of the exercise of [the chancery court's] equitable jurisdiction resulted" from the existence of an adequate remedy at law); *Bird v. Lida, Inc.*, 681 A.2d 399, 402 (Del. Ch. 1996) (Allen. C.) (holding that a claim asserting an equitable right, such as a claim based on fiduciary duty, is subject to equity jurisdiction irrespective of the remedy sought in equity or otherwise available at law); *Boxer v. Husky Oil Co.*, 429 A.2d 995, 998 (Del. Ch. 1981) (Harnett, V.C.) ("Where the relationship between the parties imposes an equitable obligation to account, equity has always taken jurisdiction over the controversy, even where there may be an adequate remedy at law."). For this reason, the Delaware Supreme Court has held that title 10, section 342 of the Delaware Code—which provides that "[t]he Court of Chancery shall not have jurisdiction to determine any matter wherein sufficient remedy may be had by common law, or statute"—"is 'a mere declaration of the ancient rule of equity' precluding equitable relief [and] . . . being a mere declaration of the ancient rule of equity, neither grants nor divests equity of any jurisdiction." *In re Arzuaga-Guevara*, 794 A.2d 579, 586 (Del. 2001) (quoting *Boxer*, 429 A.2d at 998).

equity jurisdiction applies to LLCs.¹⁴² As noted before, on this underlying constitutional question, *Bax* and *Carlisle* disagree.¹⁴³

In short, attempts to reconcile *Bax* and *Carlisle* are unconvincing. Instead, the two cases represent an unresolved conflict in Delaware law as to the role of equity in LLCs. How this conflict is ultimately

142. Equity jurisdiction means the *power* of the chancery court to hear and decide certain kinds or classes of actions according to the principles of equity jurisprudence, which decisions may involve either the determination of an equitable right or the granting of an equitable remedy. POMEROY, *supra* note 1, § 130, at 176. Whether that power *should be exercised* in any given case is subject to the principles of equity jurisprudence. Professor Pomeroy long ago bemoaned that “[e]quity jurisdiction is distinct from equity jurisprudence” and the “constant tendency to confound these two subjects . . . has been productive of much confusion.” *Id.* § 131, at 179-80. “[E]quity jurisdiction may exist over a case, although it is one which the doctrines of equity jurisprudence forbid any relief to be given, or any right to be maintained.” *Id.* § 131, at 180; *see also id.* §§ 131-33, at 179-82 (criticizing the conflation of equity jurisdiction with equity jurisprudence and the oversimplification that equity jurisdiction applies only in cases where there is a full, adequate, and complete remedy at law); *id.* §§ 217-18, 267-68 (same).

To appreciate this distinction, it can be helpful to separate *exclusive* equity jurisdiction from *concurrent* equity jurisdiction. *Exclusive* equity jurisdiction covers cases where equity recognizes and protects a right not otherwise recognized at law; the right is purely equitable in nature. MCCLINTOCK, *supra* note 11, § 42, at 102. The right to bring a derivative suit on behalf of a business entity, as was the case in *Bax*, is a good example of a right recognized by equity and, therefore, within the chancery court’s exclusive equity jurisdiction. *Concurrent* equity jurisdiction, by contrast, covers cases where equity protects a legal right with an equitable remedy, because the remedy available at law for the protection of that right is inadequate. MCCLINTOCK, *supra* note 11, § 42, at 102; *accord* Harman v. Masoneilan Int’l, Inc., 442 A.2d 487, 497 (Del. 1982) (defining the chancery court’s exclusive equity jurisdiction as “jurisdiction to hear and determine all matters and causes in equity” and its concurrent equity jurisdiction as “jurisdiction over claims for which the remedy available at law is insufficient”). For example, a suit seeking enforcement of a contract by specific performance, which is an equitable remedy, falls within the concurrent equity jurisdiction of the chancery court.

The inadequacy of available legal remedies is the foundation—an essential element—for concurrent equity jurisdiction. *See Glanding*, 45 A.2d at 559 (“[T]he very foundation of concurrent jurisdiction is predicated upon the inadequacy of the remedy at law.”); POMEROY, *supra* note 1, § 139, at 192, § 173, at 233-34, § 217, at 367. If there exists an adequate legal remedy, there is no concurrent equity jurisdiction. By contrast, “the exclusive jurisdiction of equity does not rest upon the inadequacy of legal remedies.” POMEROY, *supra* note 1, § 173, at 234. “[E]xclusive equitable jurisdiction, or the power . . . to adjudicate upon the subject-matters coming within that jurisdiction, *exists* independently of the adequacy or inadequacy of the legal remedies obtainable under the circumstances of any particular case.” *Id.* § 218, at 368. Nonetheless, the principles of equity jurisprudence that govern the proper exercise of exclusive equity jurisdiction “do also depend in some measure upon the insufficiency and inadequacy of the remedies granted by the law.” POMEROY, *supra* note 1, § 173, at 234; *accord* MCCLINTOCK, *supra* note 11, § 40, at 98-99 (“The existence of an adequate remedy at law does not exclude the power of a court of equity to act in the matter, it only makes it improper for it to act . . .”).

Applied to *Bax*, it may be the case that as a jurisprudential matter, an LLC creditor has adequate remedies at law and therefore is not deserving of the court’s equitable power to grant derivative standing. But that is not the same as saying that the court lacks the power—the equitable jurisdiction—to recognize and extend LLC derivative standing.

143. *See supra* note 130.

resolved will have profound implications for the contract-law foundations of LLC law and practice.

IV. THE RESURGENCE OF EQUITY?

Does *Carlisle* signal the demise of *Bax* and a resurgent role for equity in LLC cases? And if so, will equity upend the statutorily promised freedom of contract upon which hundreds of thousands of LLC agreements are based? Only a new decision by the Delaware Supreme Court can definitively answer these questions. While *Carlisle* was decided after *Bax*, meaning that it is the latest pronouncement from the Delaware courts on equity's role in LLC cases, *Carlisle* is still a chancery court decision. As a strictly legal matter, the chancery court cannot overrule supreme court precedent.¹⁴⁴

Nonetheless, there are good reasons to believe that *Bax* may be reversed, politely ignored, or distinguished into irrelevance. For one, as Section A explains, *Bax* is based upon a fundamental misapprehension of equity. Just as important, Section B describes changes in both Delaware's LLC statute and judiciary since the time *Bax* was decided that further erode the likelihood that *Bax* will be upheld in future cases.

A. *Bax's Misapprehension of Equity*

Admittedly, the logic of *Bax* has a seductive simplicity to it: the state constitution prohibits the legislature from reducing the chancery court's equitable powers to less than what those powers were in 1792.¹⁴⁵ LLCs did not exist in 1792.¹⁴⁶ Therefore, those equitable powers protected by the state constitution do not extend to LLCs.¹⁴⁷

This simple logic, however, is built upon a fallacious premise: that the equity jurisdiction that was vested in the chancery court in 1792 is frozen in time and incapable of adapting itself to new constructs or

144. Still, as a practical matter, *Carlisle* would not be the first time the chancery court has reversed the precedent of the high court. See Mohsen Manesh, *Damning Dictum: The Default Duty Debate in Delaware*, 39 J. CORP. L. 35, 54 (2013) [hereinafter Manesh, *Damning Dictum*] (describing *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996) as an example of the Delaware Chancery Court using dicta to overturn antiquated Delaware Supreme Court precedent).

145. See *Bax*, 28 A.3d at 1044 ("The Delaware Constitution prohibits the General Assembly from limiting the equity jurisdiction of the Court of Chancery to less than the general equity jurisdiction of the High Court of Chancery of Great Britain existing at the time of our separation from the Mother Country.").

146. *Id.* at 1045 ("[T]his case deals not with a corporation but with a statutorily created LLC—a business entity that did not exist in 1792.").

147. *Id.* ("Therefore, nothing in the Delaware Constitution precludes the General Assembly from limiting the scope of [the equitable doctrine of] derivative standing [in LLCs].").

circumstances. This premise fundamentally misapprehends equity jurisdiction. The “very nature of equity”¹⁴⁸ is to be flexible and responsive¹⁴⁹—a corrective salve where the strict application of law would otherwise serve injustice.¹⁵⁰

Indeed, in *Carlisle*, Vice Chancellor Laster emphasized equity’s intrinsically adaptive nature,¹⁵¹ quoting extensively from the Delaware Supreme Court’s opinion in *Schoon v. Smith*,¹⁵² decided just three years before *Bax*. In *Schoon*, a corporate director sought to extend the equitable right of derivative standing to enable directors, in addition to stockholders, to bring suit on behalf of a corporation.¹⁵³ In considering this issue, the supreme court set forth a lengthy and erudite discussion on “[t]he [e]xtension of [e]quitable [d]octrine” to new contexts.¹⁵⁴ The *Schoon* court observed that “equity jurisdiction ‘has taken its shape and its substance from the perceived inadequacies of the common law and the changing demands of a developing nation.’”¹⁵⁵ It “has an expansive power[] to meet new exigencies.”¹⁵⁶ After all, “the final object of equity is to do right and justice.”¹⁵⁷ Therefore, the *Schoon* court concluded, “[j]udicially-created equitable doctrines may be extended so long as the extension is consistent with the principles of equity.”¹⁵⁸

Schoon is in accord with other Delaware Supreme Court precedents. Consider, for example *Severns v. Wilmington Medical Center*,¹⁵⁹

148. See *Schoon v. Smith*, 953 A.2d 196, 204 (Del. 2008) (describing equity’s ability to evolve in order to address new developments and “perceived inadequacies of the common law” as “the very nature of equity”); cf. *Severns v. Wilmington Med. Ctr., Inc.*, 421 A.2d 1334, 1348 (Del. 1980) (“[T]he very essence of our system of equity . . . is to render the ‘jurisprudence as a whole adequate to the social needs . . . possess[ing] an inherent capacity of expansion, so as to keep abreast of each succeeding generation and age.’” (quoting POMEROY, *supra* note 1, § 67, at 89)).

149. See Quillen & Hanrahan, *supra* note 1, at 819-20 (attributing the longevity of the Delaware Chancery Court “to the Court’s ability to adapt principles of equity developed centuries ago to ever-changing economic circumstances and legal relationships”); Oleck, *supra* note 11, at 25 (“[E]quity is, or should be, a living, changing thing, forever adapting itself to new conditions The avoidance of the freezing of law into inflexible rules is one of its chief purposes.”).

150. See *supra* notes 11-22 and accompanying text.

151. See *In re Carlisle Etcetera LLC*, 114 A.3d 592, 602-03 (Del. Ch. 2015).

152. 953 A.2d 196 (Del. 2008).

153. See *id.* at 199-200.

154. *Id.* at 204-05.

155. *Id.* at 204 (quoting DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, 1 CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 2-2[a], at 2-2 (2006)).

156. *Id.* at 206 (quoting 1 STORY’S EQUITY JURISPRUDENCE 45 (Isaac F. Redfield, ed., 9th ed. 1866)).

157. *Id.* at 205 (quoting POMEROY, *supra* note 1, § 60, at 80).

158. *Id.*

159. *Severns v. Wilmington Med. Ctr., Inc.*, 421 A.2d 1334 (Del. 1980).

a case in which the petitioner sought a novel form of equitable relief: the authority to remove life support from his incurably comatose spouse.¹⁶⁰ In holding that the chancery court's historical equitable powers include the power to grant the extraordinary relief requested, the high court stated that "the very essence of our system of equity . . . [is its] inherent capacity of expansion, so as to keep abreast of each succeeding generation and age."¹⁶¹ Indeed, the *Severns* court explicitly asserted that "nothing in [*Dupont*] indicates that the [chancery court's] fashioning of [equitable] relief is limited to that which was available in 1776."¹⁶²

The *Bax* court's answer to the intrinsically adaptive nature of equity, as described in *Schoon* and *Severns*, is that it applies to corporate cases only. Citing *Schoon*, the *Bax* court asserted that "[o]ur precedent shows . . . that the common law equity power to extend derivative standing to address new circumstances is . . . *limited to the corporate context*."¹⁶³ But this limitation on equity jurisdiction is both novel and peculiar to *Bax*; it is not borne from *Schoon* to which the *Bax* court cited. To be sure, *Schoon* was decided in the corporate setting. But nothing in *Schoon*—or any other precedent—suggests that equity's ability to extend itself onto new circumstances and relations as justice dictates is limited to only the corporate context.¹⁶⁴ Indeed, the high court's extension of equity jurisdiction in *Severns* to cover the removal of life support—a remedy "novel to Delaware and, relatively speaking, . . . new in our civilization"¹⁶⁵—belies the naïve notion that equity is so historically cabined.

More importantly, even if, as *Bax* asserts, past Delaware precedents showed that equitable doctrines have been extended in only corporate cases, equity is not so strictly bound by past precedents. Recognizing equity's inherently capacious nature, the high court in *Severns* flatly stated that "the absence of precedent is no bar to the award of appropriate relief" in equity.¹⁶⁶ *Schoon* elaborated on this point, quoting at length from *Pomeroy's Equity Jurisprudence*:

160. *See id.* at 1339-40.

161. *Id.* at 1348.

162. *Id.*

163. *CML V, LLC v. Bax*, 28 A.3d 1037, 1045 (Del. 2011) (emphasis added).

164. For example, in *Schoon* the court says, speaking in the context of corporate derivative standing, that "equitable doctrine can be judicially extended to address new circumstances," without ever suggesting that those "new circumstances" must involve a corporation. *Schoon v. Smith*, 953 A.2d 196, 204 (Del. 2008).

165. *Severns*, 421 A.2d at 1349.

166. *Id.* at 1348. To support this assertion, the *Severns* court quoted at length from *American Jurisprudence*, among other sources: "The absence of a precedent for the giving of [equitable] relief in a case where it is evident that under general principles of equity relief

The true function of precedents is that of illustrating principles; they are examples of the manner and extent to which principles have been applied; they are the landmarks by which the court determines the course and direction in which principles have been carried. But with all this guiding, limiting, and restraining efficacy of prior decisions, the Chancellor always has had, and always must have, a certain power and freedom of action, not possessed by the courts of law, of adapting the doctrines which he administers. *He can extend those doctrines to new relations, and shape his remedies to new circumstances, if the relations and circumstances come within the principles of equity . . .*¹⁶⁷

Echoing these fundamental precepts, Chancellor Allen presciently observed—just five years before the Delaware LLC statute was enacted—that “[t]he nature of chancery’s particular mission forecloses the development of fixed and limited categories of relationships over which equity will take jurisdiction . . . We cannot predict all categories of relationships in which that power may properly be called into action.”¹⁶⁸

In this regard, *Bax*’s attempt to confine equity to “fixed and limited categories of relationships”—namely corporations and other business forms in existence at the time of this nation’s independence—runs counter to the very nature of equity. It contradicts a basic maxim of

should be granted is of no consequence and presents no obstacle to the exercise of the jurisdiction of an equity court.” *Id.* (quoting 27 AM. JUR. 2D *Equity* § 121); *accord* *Neal v. Ala. By-Products Corp.*, 1988 WL 105754, at *5 (Del. Ch. Oct. 11, 1988) (Berger, V.C.) (“[L]ack of precedent is not a bar to the exercise of this Court’s equitable powers.”)

167. *Schoon*, 953 A.2d at 204-05 (quoting POMEROY, *supra* note 1, § 60, at 77-78) (emphasis added). Elsewhere, Professor Pomeroy explained in his widely-cited treatise:

[T]he already settled principles of equity jurisprudence. . . may *unquestionably be extended to new facts and circumstances* as they arise, which are analogous to facts and circumstances that have already been the subject-matter of judicial decision . . .

All who are conversant with the history of equity jurisprudence know that . . . it has been of constant growth and development from its inception . . . The jurisdiction of a court of equity does not depend upon the mere accident whether the court has, in some previous case or at some distant period of time, granted relief under similar circumstances, but rather upon the necessities of mankind . . .

POMEROY, *supra* note 1, § 47, at 62, § 67, at 89-90 (emphasis added); In addition to *Pomeroy’s Equity Jurisprudence*, the *Schoon* court also cites *McClintock on Equity*, *supra* note 11, § 4, at 10, for the proposition that “the chancellors could adapt their system to meet changing needs without resorting to the fiction that they were merely interpreting and applying former rules, but the tendency to follow the path laid out by former chancellors was strong.” *Schoon*, 953 A.2d at 205 n.24.

168. *McMahon v. New Castle Assoc.*, 532 A.2d 601, 605 (Del. Ch. 1987).

equity: that equity regards substance rather than form.¹⁶⁹ LLCs represent precisely the type of analogous “new relations” to which Professor Pomeroy alluded.¹⁷⁰ Yet, by excluding LLCs from the domain of equity based solely upon the historical date the LLC form came into existence, *Bax* ironically smacks of the very rigidity and technical formalism to which equity originally arose as an ameliorative.

B. Subsequent Changes Undermining *Bax*

By starting with a flawed premise, *Bax* reaches a flawed conclusion. This alone would be reason enough to believe that future cases will disavow, disregard, or distinguish *Bax* and instead embrace *Carlisle’s* characterization of equity jurisdiction as applied to LLCs. But events since the time *Bax* was decided only reaffirm this prediction. Since *Bax*, changes in both Delaware’s LLC statute and its state bench suggest the ‘purely contractarian’ view of LLCs, upon which *Bax* was based, no longer has purchase.

1. Changes in the LLC Statute

At the time *Bax* was decided, there was an ongoing debate among members of the bar, bench, and academy about the role of equity in LLCs.¹⁷¹ Some advocated for a “purely contractarian” view of the

169. POMEROY, *supra* note 1, § 378, at 40-41 (“[E]quity regards substance rather than form . . . Equity always attempts to get at the substance of things, and to ascertain, uphold, and enforce rights and duties which spring from the *real* relations of parties.”).

170. Kelly v. Blum, No. 4516-VCP, 2010 WL 629850, at *11 n.73 (Del. Ch. Feb. 24, 2010) (Parsons, V.C.) (“Manger-managed LLCs are, in many ways, analogous to corporations, whereas member-managed LLCs may be more analogous to a partnership.”); *cf.* Auriga Capital Corp. v. Gatz Props., LLC, 40 A.3d 839, 850 (Del. Ch. 2012) (Strine, C.) (“The manager of an LLC—which is in plain words a limited liability “company” *having many of the features of a corporation*—easily fits the definition of a fiduciary.” (emphasis added)).

171. The debate divided into three camps. Anti-contractarians believe that the equitable principle of fiduciary duty should not be subject to contractual limitations or waivers. *See, e.g.*, Callison & Vestal, *supra* note 5; Reza Dibadj, *The Misguided Transformation of Loyalty into Contract*, 41 TULSA L. REV. 451 (2006); Kleinberger, *supra* note 2; Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295, 315-24 (2014); Sandra K. Miller, *Fiduciary Duties in the LLC: Mandatory Core Duties to Protect the Interests of Others Beyond the Contracting Parties*, 46 AM. BUS. L.J. 243, 254-60 (2009); Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609 (2004). Traditional contractarians believe that the equitable principle of fiduciary duty should be the default rule, but subject to contractual limitations or waivers. *See, e.g.*, Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 249 (“[A]s in limited partnerships and corporations, managers of manager-managed LLCs should have default fiduciary duties.”); Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U. L. REV. 927, 965 (2004) (“Fiduciary duties in business associations should be regarded as default rules that work together with, and can be displaced by, explicit provisions of the contract.”); Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 147

LLC.¹⁷² Under the “purely contractarian” view, an LLC agreement is like any other contract.¹⁷³ As a contract, the relationship of the members and managers involved in an LLC is defined by the terms of their LLC agreement, rather than by any judicially imposed rights and obligations.¹⁷⁴ Put differently, as a purely contractual entity, LLCs do not operate against the same background of equity, including fiduciary duties, that courts have traditionally applied to corporations and partnerships.¹⁷⁵ In support of the purely contractarian view, adherents pointed to Delaware’s strong legislative policy favoring the freedom of contract for LLCs,¹⁷⁶ arguing that this statutory language confirms LLCs are defined solely by contract and not by equitably implied rights

(arguing, in the limited partnership context, that “only where that [governing] document is silent or ambiguous” should a court “look for guidance from the statutory default rules [or] traditional notions of fiduciary duties”). Finally, pure contractarians believe that the LLC is a purely contractual relationship to which the equitable principle of fiduciary duty is inapplicable even as default rule. *See, e.g., Fisk Ventures LLC v. Segal*, No. 3017–CC, 2008 WL 1961156, at *1 (Del. Ch. May 7, 2008) (Chandler, C.) *aff’d* 984 A.2d 124 (Del. 2009) (“[A]ffirmed on the basis of and *for the reasons* assigned by the Court of Chancery.” (emphasis added)); Ann E. Conaway & Peter I. Tsoflias, *Challenging Traditional Thought: No Default Fiduciary Duties in Delaware Limited Liability Companies After Auriga*, 13 J. BUS. & SEC. L. 1 (2012); Myron T. Steele, *Freedom of Contract and Default Contractual Duties in Delaware Limited Partnerships and Limited Liability Companies*, 46 AM. BUS. L.J. 221 (2009); Nicole M. Sciotto, Note, *Opt-In vs. Opt-Out: Settling the Debate over Default Fiduciary Duties in Delaware LLCs*, 37 DEL. J. CORP. L. 531 (2012).

172. *Fisk Ventures*, 2008 WL 1961156, at *1 (Chandler, C.) (“Contractual language defines the scope, structure, and personality of [LLCs].”); Conaway & Tsoflias, *supra* note 171, at 6 (“[F]reedom of contract’ signifies to a reviewing court that a Delaware LLC is a bargained-for, contractual entity”); Sciotto, *supra* note 171, at 555 (“LLCs are ‘creatures of contract’ whose relationships must be governed solely by the LLC agreement’s terms”); Steele, *supra* note 171, at 242 (arguing that “courts should analyze LLC agreements by the parties’ agreement alone” without reference to default equitable principles).

173. *Fisk Ventures*, 2008 WL 1961156, at *8 (Chandler, C.) (“In the context of [LLCs], which are creatures not of the state but of contract, [those] duties or obligations [of the parties] must be found in the LLC Agreement or some other contract.” (footnote omitted)); Steele, *supra* note 171, at 235 (asserting that with respect to the interpretation of LLC agreements “my answer is simple: treat it like a contract”).

174. *See supra* note 172.

175. *See* Conaway & Tsoflias, *supra* note 171, at 11-12 (arguing that LLCs, unlike corporations, general partnerships and limited partnerships, do not warrant judicially imposed fiduciary duties); Sciotto, *supra* note 171, at 561 (same).

176. DEL. CODE ANN. tit. 6, § 18-1101(b) (2016).

or obligations.¹⁷⁷ This statutory language, adherents argued, even displaced the “rules of law and equity” that the LLC statute provides would otherwise apply in LLC cases.¹⁷⁸

The purely contractarian view of LLCs appears to have animated the Delaware Supreme Court’s ruling in *Bax*. In rejecting the notion that the chancery court’s constitutionally vested equity jurisdiction extends to LLCs, the high court reasoned that LLCs do not operate against the background of equity that applies to corporations.¹⁷⁹ This reasoning makes sense if LLCs, unlike corporations, represent a purely contractual relationship.

In this regard, *Bax* laid the foundation for the high court’s more notorious ruling in *Gatz Properties v. Auriga Capital*,¹⁸⁰ decided just fourteen months later. Recall in *Gatz*, then-Chancellor Strine held in the chancery court that individuals vested with discretionary power to manage the business of an LLC owe a fiduciary duty to the LLC and its members unless those duties are modified or waived by the terms of the LLC agreement.¹⁸¹ On appeal, the Delaware Supreme Court cast doubt on this seemingly uncontroversial holding.¹⁸² Calling into question a long line of chancery court precedents,¹⁸³ the high court suggested that fiduciary duties are not just subordinate to the freedom of contract, but *wholly inapplicable* to LLCs.¹⁸⁴ Although the high court’s ruling in *Gatz* surprised many academics, practitioners, and

177. See, e.g., *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at *4 (Del. Ch. Aug. 19, 2008) (citing the statutorily prescribed “freedom of contract” to assert that LLCs are “creatures of contract” (internal citations omitted)); *Conaway & Tsoflias*, *supra* note 171, at 4 (citing the statutorily prescribed “freedom of contract” to assert that LLCs are “contractual in nature; and [therefore,] [] contractual principles were to be given dominance above tort-based, fiduciary principles”); Steele, *supra* note 171, at 234 (“[The] general principle of freedom of contract announced by the legislature indicates that courts should not assume that default fiduciary duties apply.”).

178. See *Conaway & Tsoflias*, *supra* note 171, at 27 (arguing that the Delaware LLC statute’s express policy of freedom of contract “fill[s] the void” in which the rules of “law and equity” provision might otherwise apply); *Sciotto*, *supra* note 171, at 556 (“[T]he unambiguous legislative intent to ‘give [sic] the maximum effect to the principle of freedom of contract’ read in tandem with the statutory authorization permitting the elimination or modification of fiduciary duties, ostensibly displaces any reliance upon the catch-all ‘law and equity’ provision” (quoting *Auriga*, 40 A.3d 839, 849-52 (Del. 2012))).

179. See *supra* notes 99-108 and accompanying text.

180. *Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206 (Del. 2012). See generally *Manesh, Damning Dictum*, *supra* note 144 (criticizing the Delaware Supreme Court’s decision in *Gatz*).

181. See *supra* notes 46-48 and accompanying text.

182. See *Gatz*, 59 A.3d at 1218-19.

183. See *supra* notes 44-45 and accompanying text.

184. See *Gatz*, 59 A.3d at 1218-19 (asserting that “reasonable minds could differ” on the question of whether fiduciary duties apply to LLCs, even in the absence of an agreement limiting or eliminating such duties); see also *Manesh, Damning Dictum*, *supra* note 144, at 48 (“[T]he supreme court [in *Gatz*] made clear that going forward, contract drafters and parties to LLC agreements could no longer take default fiduciary duties for granted.”).

jurists,¹⁸⁵ it was entirely consistent with *Bax*'s purely contractarian view of LLCs.¹⁸⁶ After all, under the purely contractarian view, the relationship among members and managers in a LLC is contractual. And the only judicially implied duty owed by contract parties is the implied covenant of good faith and dealing.¹⁸⁷ Contract parties are not fiduciaries of one another.¹⁸⁸

The purely contractarian view of LLCs has always been flawed. LLCs, like other business entities, provide parties with legal benefits that simply cannot be contracted for by individuals through private agreement.¹⁸⁹ As Vice Chancellor Laster concisely observed in *Carlisle*,

[T]he purely contractarian view discounts core attributes of the LLC that only the sovereign can authorize, such as its separate legal existence, potentially perpetual life, and limited liability for its members. . . . [W]hen a sovereign makes available an entity with attributes that contracting parties cannot grant themselves by agreement, the entity is not purely contractual. . . .

. . . .

. . . Put more directly, an LLC agreement is not an exclusively private contract among its members precisely because the LLC has powers that only the State of Delaware can confer.¹⁹⁰

For this reason, it has never been quite correct to suggest that LLCs are merely "creatures of contract," as courts sometimes do.¹⁹¹ Although

185. See Manesh, *Damning Dictum*, *supra* note 144, at 48.

186. Indeed, in assessing *Bax*, one noted attorney presciently predicted that *Bax*'s "treatment of . . . equity jurisdiction . . . may be most interesting over time. . . . [O]ne might watch for a contractarian expansion of the originalist position [espoused in *Bax*] in the case of LLC fiduciary duties." Bill Callison, *Thoughts on Creditor Fiduciary Duties After CML V v. Bax*, CONGLOMERATE BLOG (Sept. 13, 2011), <http://www.theconglomerate.org/2011/09/thoughts-on-creditor-fiduciary-duties-after-cml-v-v-bax.html> [<https://perma.cc/62MH-HSR4>].

187. RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); Mohsen Manesh, *Express Terms and the Implied Contractual Covenant of Delaware Law*, 38 DEL. J. CORP. L. 1, 3 (2013) [hereinafter Manesh, *Express Terms*] ("Like the law of other states, the Implied Covenant is an unwaivable obligation implied into every contract under Delaware law."); Steele, *supra* note 171, at 234 ("Under Delaware contract jurisprudence, Delaware courts have limited their application of default duties to the implied contractual duty of good faith and fair dealing.")

188. See Conaway & Tsoflias, *supra* note 171, at 2, 4-5 (endorsing the purely contractarian view and asserting that "fiduciary duties are unnecessary in the LLC business form" because "[c]ontract law does not impose fiduciary duties between parties").

189. See *In re Carlisle Etcetera LLC*, 114 A.3d 592, 605-06 (Del. Ch. 2015) (noting flaws in the "purely contractarian" view of LLCs); Johnson, *supra* note 22, at 721 ("[A]ll . . . business statutes . . . confer state-ordained benefits—limited liability being the obvious example that participants themselves do not and cannot create by contract *inter se*.").

190. *Carlisle*, 114 A.3d at 605-06 (citation omitted).

191. See, e.g., *Kelly v. Blum*, No. 4516-VCP, 2010 WL 629850, at *7 (Del. Ch. Feb. 24, 2010) (Parsons, V.C.) ("LLCs are creatures of contract"); *R & R Capital, LLC v.*

LLCs are *primarily* “creatures of contract,” they are also inescapably creatures of the state, just like other statutory business forms.¹⁹²

Whatever the merits of the purely contractarian view of LLCs, it has now been soundly rejected by the Delaware General Assembly.¹⁹³ In 2013, the Delaware legislature amended the LLC statute to provide that “[i]n any case not provided for in this chapter, the rules of law *and equity, including the rules of law and equity relating to fiduciary duties . . .* shall govern.”¹⁹⁴ This amendment was passed as a direct response to the high court’s *Gatz* decision.¹⁹⁵ In amending the LLC statute, the Delaware General Assembly confirmed that LLCs are not purely contractual entities, but instead are a form of business association that operates against the same background “of law and equity, including the rules of law and equity relating to fiduciary duties” that applies to other business forms.¹⁹⁶

Buck & Doe Run Valley Farms, LLC, No. 3803-CC, 2008 WL 3846318, at *4 (Del. Ch. Aug. 19, 2008) (Chandler, C.) (“[LLCs] are creatures of contract, ‘designed to afford the maximum amount of freedom of contract, private ordering and flexibility to the parties involved.’” (quoting *Travel Ctrs. of Am., LLC v. Brog, C.A.*, No. 3516-CC, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008))); *Fisk Ventures, LLC v. Segal*, No. 3017-CC, 2008 WL 1961156, at *8 (Del. Ch. May 7, 2008) (Chandler, C.) (“In the context of [LLCs], which are creatures not of the state but of contract, [any] duties or obligations must be found in the LLC [a]greement . . .”); *accord In re Atlas Energy Res., LLC*, No. 4589-VCN, 2010 WL 4273122, at *6 (Del. Ch. Oct. 28, 2010) (Noble, V.C.).

192. See *Johnson*, *supra* note 22, at 721 (“Of course, like many close business arrangements, . . . [LLCs] are creatures of both statute and contract.”); *accord* REVISED UNIFORM LIMITED LIABILITY COMPANY ACT § 110 cmt. (UNIF. LAW COMM’N 2006) (“A [LLC] is as much a creature of contract as of statute.”); *Obeid v. Hogan*, No. 11900-VCL, 2016 WL 3356851, at *5, n.2 (Del. Ch. June 10, 2016) (Laster, V.C.) (“It is frequently observed that LLCs ‘are creatures of contract,’ which they primarily are. . . . The adverb ‘primarily’ recognizes the critical but sometimes overlooked non-contractual dimensions of the entity.”); *Brog*, No. 3751-CC, 2008 WL 5272861, at *2 (“[LLCs] are *primarily* creatures of contract.” (emphasis added)). Even former Chief Justice Myron Steele, a leading advocate of the purely contractarian view, is forced to concede the inexorable role of the state in LLCs when he acknowledges that LLCs exist due to state statutes. See, e.g., *CML V, LLC v. Bax*, 28 A.3d 1037, 1045 (Del. 2011) (Steele, C.J.) (“[W]hen adjudicating the rights, remedies, and obligations associated with Delaware LLCs, courts must look to the LLC Act because it is only the statute that creates those rights, remedies, and obligations.”); Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 5 (2007) [hereinafter Steele, *Judicial Scrutiny*] (“[L]imited partnerships and [LLCs], like corporations, are creatures of statute . . .”).

193. See *Carlisle*, 114 A.3d at 605 (“[T]he General Assembly in 2013 adopted an amendment to the LLC Act inconsistent with the purely contractarian view.”); *Jowers & Adams*, *supra* note 122, at 1 (“Both the case law [citing *Carlisle*] and an amendment to the Delaware [LLC statute] in recent years demonstrate Delaware’s rejection of a solely contractarian view of LLCs.”).

194. H.B. 126, 147th Gen. Assemb., Reg. Sess. (Del. 2013).

195. See *Manesh*, *Damning Dictum*, *supra* note 144, at 67-68.

196. See *Jowers & Adams*, *supra* note 122, at 3 (“The debate regarding whether a Delaware LLC should be viewed as a purely contractual entity to which principles of equity (including fiduciary duties) do not apply was resolved in 2013 when the Delaware General Assembly adopted [the] amendment to [the state’s LLC statute].”).

The legislature's rejection of *Gatz* also has clear implications for *Bax*. By confirming that traditional equitable principles apply to LLCs, the 2013 amendment repudiates *Bax*'s central conclusion. With this central tenant of *Bax* now undermined by the state's legislature, Delaware jurists may not feel bound to follow *Bax* in future cases despite principles of *stare decisis*. Indeed, this consideration, in part, is what motivated Vice Chancellor Laster to depart from *Bax* in *Carlisle*.¹⁹⁷ After all, if traditional equitable principles apply to LLCs, as the Delaware statute now explicitly makes clear,¹⁹⁸ then the chancery court's jurisdiction to apply and enforce those principles is constitutionally protected.¹⁹⁹

2. Changes Among the Delaware Judiciary

Aside from the recent change to the Delaware LLC statute, there is another reason to question *Bax*'s continued viability as binding precedent. Since *Bax* was decided, the leading advocate of the purely contractarian view of LLCs has left the Delaware Supreme Court and been replaced by a jurist with a decidedly different perspective.

Writing academically, in an extrajudicial capacity, the former Chief Justice of the Delaware Supreme Court, Myron Steele, was a forceful proponent of the purely contractarian view of LLCs.²⁰⁰ Later, the chief justice would author the *Bax* decision and also likely had a strong influence in *Gatz*, an unsigned per curiam opinion.²⁰¹ As noted above, both decisions are grounded in the purely contractarian perspective.²⁰²

197. See *Carlisle*, 114 A.3d at 605 (“[T]he General Assembly in 2013 adopted an amendment to the LLC Act inconsistent with the purely contractarian view.”).

198. See DEL. CODE ANN. tit. 6, § 18-1104 (2016).

199. Although the statutory language suggests that equitable principles are merely a gap-filler in the LLC context, applicable only where the statute or relevant LLC agreement does not address a particular matter, the statute nonetheless reflects the legislature's concession that traditional equitable principles do in fact apply to LLCs. This concession is important, because if traditional equitable principles do apply to LLCs, then the chancery court's jurisdiction to recognize and apply those principles is constitutionally protected.

200. See generally Steele, *supra* note 171 (espousing the purely contractarian view); see also Q&A with Chief Justice Myron T. Steele of the Delaware Supreme Court, PRAC. L.J. (Dec. 1, 2012), <http://us.practicallaw.com/3-515-1049> [<http://perma.cc/B4J7-95P3>] (“Those who advocate for default fiduciary duties . . . miss the fact that the LLC . . . statute's explicit policy is to maximize contractual freedom. The way to maximize contractual freedom is to look at . . . the contract. . . [LLC parties'] entire relationship is driven by the terms of the contract.”).

201. See Manesh, *Damning Dictum*, *supra* note 144, at 62-64 (arguing that the unanimity norm at the Delaware Supreme Court coupled with Chief Justice Steele's idiosyncratic, purely contractarian view of LLCs, resulted in the per curiam opinion in *Gatz*); D. Gordon Smith, *Contractually Adopted Fiduciary Duty*, 2014 U. ILL. L. REV. 1783, 1791 (observing that the *Gatz* opinion “bears the fingerprints of . . . Chief Justice . . . Steele”).

202. See *supra* notes 179-88 and accompanying text.

Since *Bax* and *Gatz*, Chief Justice Steele has retired from the bench.²⁰³ He was succeeded by Leo Strine, formerly the Chancellor of the Delaware Chancery Court and before that a Vice Chancellor.²⁰⁴ There is, of course, a delicious coincidence in this choice of replacement. Then-Chancellor Strine was the author of the chancery court *Gatz* opinion that the supreme court repudiated on appeal.²⁰⁵

A cursory review of then-Chancellor Strine's chancery court opinion in *Gatz* makes clear that he disagrees with the purely contractarian premise that traditional equitable principles are inapplicable to LLCs. In *Gatz*, the then-chancellor variously described LLCs as subject to an "equity backdrop," "equitable background," and "equity overlay."²⁰⁶ And applying "traditional and settled principles of equity," he concluded that "[m]anagers of LLCs *easily* qualify as fiduciaries."²⁰⁷

To be sure, like other Delaware jurists, Chief Justice Strine has in the past recognized and deferred to the freedom of contract mandated by the LLC statute.²⁰⁸ But the chief justice has yet to express an opinion on how this statutorily mandated freedom of contract interacts with the chancery court's constitutionally vested equitable powers. Having acknowledged that traditional principles of equity apply to LLCs, it follows that the chancery court's jurisdiction to recognize and apply those principles is constitutionally protected. And because that jurisdiction is constitutionally protected, the chancery court's equitable powers cannot be abridged by legislation or private agreement.

Finally, lest one might overly focus on the views of one chief justice, it bears noting that he is only one of five members of the Delaware Supreme Court. Like the now-retired chief justice, the four other members of the *Bax* Court also no longer serve as justices on the high

203. See *Chief Justice Steele Retiring*, THE NEWS J., Sep. 7, 2013.

204. See *Strine Officially Sworn in*, THE NEWS J., Mar. 1, 2014.

205. See *supra* notes 180-88 and accompanying text.

206. See *Auriga Capital Corp. v. Gatz Props., LLC*, 40 A.3d 839, 851, 853, 854 (Del. Ch. 2012) (Strine, C.).

207. *Id.* at 854 (emphasis added); *accord id.* at 856 n.65 ("[M]anagers of LLCs owe fiduciary duties because they fit within the classic definition of a fiduciary of a business enterprise under traditional principles of equity.").

208. See, e.g., *id.* at 852 (Strine, C.) ("Where the parties [to an LLC agreement] have clearly supplanted default principles [of fiduciary duty] in full, we give effect to the parties' contract choice."); *Related Westpac LLC v. Jer Snowmass LLC*, No. 5001-VCS, 2010 WL 2929708, at *8 (Del. Ch. July 23, 2010) (Strine, V.C.) ("When . . . [parties] cover a particular subject in an express manner, their contractual choice governs and cannot be supplanted by the application of inconsistent fiduciary duty principles that might otherwise apply as a default."); *R.S.M. Inc. v. All. Capital Mgmt. Holdings L.P.*, 790 A.2d 478, 497 (Del. Ch. 2001) (Strine, V.C.) (observing in the limited partnership context that "where the use of default fiduciary duties would intrude upon . . . contractual rights . . . or be insensible in view of the contractual mechanisms governing the transaction under consideration, the court will eschew fiduciary concepts and focus on a purely contractual analysis of the dispute").

court.²⁰⁹ None of the state supreme court's new appointees have yet expressed an opinion on the constitutional question.²¹⁰ But given Chief Justice Strine's outsized role in the development of Delaware corporate and alternative entity law as well as the unanimity norm among the Delaware justices,²¹¹ it is likely his views will be influential on his new colleagues.

V. PRACTICAL CONSEQUENCES

Based on the foregoing discussion, *Bax's* precedential value is at best dubious. Still, even if *Carlisle* portends the demise of *Bax* and a reinvigorated role for equity, the overt consequences will be modest in practice. Equity is unlikely to upend the hundreds of thousands of agreements governing Delaware LLCs today. As Section A explains, both policy and pragmatic considerations suggest the Delaware Chancery Court will be judiciously sparing in the use of its constitutionally vested equitable powers. Given the central importance of certainty and predictability in business relations, the court is unlikely to subvert the express terms of an LLC agreement in order "to do right and justice" in all but the most exceptional cases. One exceptional circumstance, Section B suggests, may be that of involving publicly traded LLCs and limited partnerships, where the courts have otherwise struggled to obtain just results in the face of prolix, unread, and unnegotiated agreements that authorize bad faith or self-dealing. But even in this narrow context, the judicial use of equitable power will be tempered by the availability of adequate legal remedies and market-based considerations that weigh against the exercise of equitable discretion.

Consequently, the practical role of equity in LLCs will be more subtle than overt. Because even if the Delaware courts seldom assert their equitable jurisdiction, the very existence of an unwaivable judicial power "to do right and justice" may chasten parties against brazen overreach in the drafting of LLC agreements

209. *Bax* was a unanimous opinion of Justices Steele, Holland, Berger, and Ridgely (along with Judge Bradley, a lower court judge who participated in the *Bax* case *ad hoc* pursuant to the high court's internal procedures). Since *Bax*, Justices Steele, Berger, Ridgely, and Holland have all retired from the Delaware Supreme Court. See CML V, LLC v. Bax, 28 A.3d 1037 (Del. 2011); David Marcus, *Ridgely Becomes Fourth in String of Delaware Justices to Step Down*, THE DEAL, Nov. 10, 2014; David Marcus, *Holland to Retire from Delaware Supreme Court*, THE DEAL, Feb. 19, 2017.

210. *But see* Trusa v. Nepo, No. CV 12071-VCMR, 2017 WL 1379594, at *8 (Del. Ch. Apr. 13, 2017) (Montgomery-Reeves, V.C.) (citing *Carlisle* to recognize the power of the chancery court to order equitable dissolution of an LLC).

211. See generally David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 VA. L. REV. 127 (1997) (describing and providing evidence of the unanimity norm among the justices of the Delaware Supreme Court).

or exploitation in performance thereunder.²¹² Put differently, freedom of contract will subsist, but it will be exercised always in the shadow of the courts' equitable power.²¹³

A. Constraints on Unbridled Equity

To say that the Delaware state constitution precludes any state statute or LLC agreement from divesting the chancery court of its equitable powers, as *Carlisle* did, does not mean that the terms of an LLC agreement that purport to limit fiduciary duties or other equitable rights or obligations are per se invalid.²¹⁴ Rather, it simply means that the chancery court need not unquestioningly defer to the language of an LLC agreement in every conceivable circumstance—especially in light of conduct that is manifestly opportunistic, exploitative, or otherwise inequitable.²¹⁵

Judicial disregard of express contract terms in the face of inequitable circumstances is not novel to LLC law. Consider *Haley v. Talcott*,²¹⁶ a case decided by Chief Justice Strine, then a vice chancellor, a decade before *Carlisle*. In *Haley*, the then-vice chancellor ordered the dissolution of an LLC on equitable grounds despite the fact that the governing LLC agreement included a “detailed exit provision” for the petitioning member to withdraw from the business without the LLC’s dissolution.²¹⁷ Acknowledging that the “contract-law foundations” of LLC law, “grounded on principles of freedom of contract[,] . . . bear[] on the propriety of ordering dissolution,”²¹⁸ the vice chancellor nonetheless ordered dissolution, explaining that the “exit mechanism [set forth in the LLC agreement] fails as an adequate remedy . . . because it does

212. Cf. Mohsen Manesh, *Indeterminacy and Self-Enforcement: A Defense of Delaware's Approach to Director Independence in Derivative Litigation*, 6 J. BUS. & SEC. L. 177, 197 (2006) (arguing that Delaware law's indeterminate standards for director independence encourage boards to self-police to avoid judicial scrutiny of suspect director relationships).

213. Cf. Lyman Johnson, *Enduring Equity in the Close Corporation*, 33 W. NEW ENG. L. REV. 313, 330-36 (2011) (describing the vital role of equity in corporate law and the enduring “uneasy tension” between law and equity); Mark J. Loewenstein, *Equity and Corporate Law*, 68 SMU L. REV. 783, 789-92 (2015) (arguing that equity introduces uncertainty and undermines private ordering in corporate law).

214. See Johnson, *supra* note 22, at 718-19.

215. See *id.*; *id.* at 721 (arguing that it, in light of the chancery court's constitutionally vested equity power, the proper construction of the LLC statute is to permit fiduciary waivers, but not in every conceivable instance).

216. *Haley v. Talcott*, 864 A.2d 86 (Del. Ch. 2004).

217. *Id.* at 97-98.

218. *Id.* at 93, 96.

not equitably effect the separation of the parties” given the specific circumstances of that case.²¹⁹

Admittedly, in asserting equity over the “detailed” terms of the LLC agreement, *Haley* did not explicitly rely on the chancery court’s constitutionally protected equitable jurisdiction. *Carlisle*, however, furnishes the constitutional basis for *Haley*. Even though *Carlisle* addressed a statutory provision, rather than an LLC agreement, Vice Chancellor Laster made clear in dicta that, as a constitutional matter, the chancery court retains the equitable discretion to disregard the express terms of an LLC agreement where equity demands it.²²⁰

In exercising this equitable discretion, a court might consider a variety of factors²²¹: the sophistication of the parties to the LLC agreement; whether that agreement was negotiated, a form agreement,²²² or unilaterally drafted and offered on a take-it-or-leave-it basis; how specifically the contractual language in that agreement condones the challenged conduct or otherwise addresses the circumstances at issue;²²³ the moral or commercial repugnance of the

219. *Id.* at 98. Although the petitioning member seeking judicial dissolution could have exercised his rights under the LLC agreement to withdraw from the LLC and receive fair market value for his share of the business, his withdrawal would not relieve him of his obligation as a personal guarantor of a mortgage on the LLC’s assets. *Id.* at 88. Consequently, the petitioning member “would still be left holding the bag on the guaranty. It is therefore not equitable to force [him] to use the exit mechanism [set forth in the LLC agreement] in this circumstance,” the court ruled. *Id.* at 98 (footnote omitted).

220. *See In re Carlisle Etcetera LLC*, 114 A.3d 592, 605 (Del. Ch. 2015) (“This court has held that the parties to an LLC agreement can waive by contract the right to seek statutory dissolution In my view, the ability to waive [statutory] dissolution . . . does not extend to a party’s standing to seek dissolution in equity.” (citations omitted)); *cf. Huatuco v. Satellite Healthcare & Satellite Dialysis of Tracy, LLC*, No. 8465–VCG, 2013 WL 6460898, at *1 n.2 (Del. Ch. Dec. 9, 2013) (questioning “[w]hether [LLC] parties may, by contract, divest this Court of its authority to order a dissolution in *all* circumstances, even where it appears manifest that equity so requires”), *aff’d*, 93 A.3d 654 (Del. 2014) (unpublished table decision); *Jowers & Adams, supra* note 122, at 1 (“Based on *Carlisle*, the Court of Chancery may use its equitable powers to dissolve a Delaware LLC even where neither the operating agreement nor the LLC Act expressly permits such dissolution.”). *But see R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at *4-6 (Del. Ch. Aug. 19, 2008) (holding that an LLC agreement may eliminate the right to judicial dissolution).

221. *See Johnson, supra* note 22, at 719 (describing a similar set of factors relevant to the exercise of equitable discretion).

222. *See Carlisle*, 114 A.3d at 594, 606-07 (exercising equitable discretion to order dissolution where the parties used a “simple form” LLC agreement that did not accurately reflect the LLC parties’ intended bargain).

223. *See infra* note 233 and accompanying text.

challenged conduct or circumstances; as well as whether available legal remedies would be adequate.²²⁴ How these factors weigh in any given case is necessarily context specific.²²⁵

But one factor that must be weighed in every case is the central importance of certainty and determinacy in business relationships generally²²⁶ and LLCs in particular.²²⁷ To the extent the courts exercise their constitutionally protected equitable power to override the express terms of a particular LLC agreement, the courts undercut the ability of all parties to rely on such agreements. Such uncertainty complicates business planning and promotes costly litigation.²²⁸ It risks undermining parties' bargained-for risk allocation and the contractual and extra-contractual mechanisms upon which that allocation was based.²²⁹ Put differently, even putting aside Delaware's statutory mandate, the freedom of contract and the enforceability of bargained-for

224. See, e.g., *Huatuco*, 2013 WL 6460898, at *6 (denying petition for judicial dissolution where the plaintiff may have an adequate legal remedy in a suit for breach of contract); see also *infra* notes 259-64 and accompanying text.

225. See Johnson, *supra* note 22, at 719 ("This [equitable] analysis will, as always, require the weighing of several factors and, ultimately, demands the exercise of judgment [by the court] . . .").

226. See e.g., Johnson, *supra* note 22, at 721 ("A stronger case for [fiduciary] waivers would focus on the desirability of greater certainty and determinacy in intra-firm relations . . ."); *Id.* at 719 (arguing that courts must exercise equitable discretion "with mindfulness being given not only to the interest of the parties before the court but also to the ramifications for business dealings more generally"); see also Bainbridge, *supra* note 28, at 514 ("[C]orporate law's main goals ought to be certainty and predictability. Uncertainty about the contours and content of a legal rule imposes substantial costs." (footnote omitted)); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. R. 1908, 1919 (1998) (emphasizing the importance of determinacy in corporate law).

227. See *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at *8 (Del. Ch. Aug. 19, 2008) (Chandler, C.) ("The allure of the [LLC], however, would be eviscerated if the parties could simply petition this court to renegotiate their agreements when relationships sour."); *Haley v. Talcott*, 864 A.2d 86, 88 (Del. Ch. 2004) (Strine, V.C.) ("A principle attraction of the LLC form of entity is the statutory freedom granted to members to shape, by contract, their own approach to common business 'relationship' problems."); Manesh, *Market for LLC Law*, *supra* note 2, 226-34 (arguing that a principal advantage of LLC law is that freedom of contract enables LLCs to avoid the costs and uncertainty associated with indeterminate principles of fiduciary duty); cf. Stephen M. Bainbridge, *Abolishing LLC Veil Piercing*, 2005 U. ILL. L. REV. 77, 78 (criticizing the doctrine of LLC veil piercing for creating "only uncertainty and lack of predictability, thus increasing transaction costs for small businesses").

228. See Manesh, *Legal Asymmetry*, *supra* note 53, at 503; cf. Steele, *supra* note 171, at 241 (arguing that the judicial imposition of fiduciary duties in LLCs increases litigation costs).

229. See Suren Gomstian, *Contractual Mechanisms of Investor Protection in Non-Listed Limited Liability Companies*, 60 VILL. L. REV. 955, 957 (2015) (providing evidence that participants in privately held LLCs utilize contractual substitutes in lieu of statutory default rules, such as fiduciary duties, to ensure equivalent protection of investors); John Goodgame, *Master Limited Partnership Governance*, 60 BUS. LAW. 471, 474-79 (2005) (identifying various contractual "obligations and incentives likely [to] promote proper management" of a publicly traded limited partnership); Manesh, *Contractual Freedom*, *supra* note 53, at 597 n.229 (acknowledging that beyond the express terms of the governing agreement "capital,

agreements are intrinsically important values that must be considered in any equitable analysis.

Delaware courts have routinely cited the vital importance of certainty and determinacy in express contractual obligations when rejecting claims based on the implied contractual covenant of good faith and fair dealing²³⁰—a contract law doctrine that affords courts room to exercise equitable discretion²³¹ and, like the courts' equity jurisdiction, cannot be waived by the terms of an LLC agreement.²³² For

product, and labor markets (although not the market for control) may play an important role in incentivizing and holding alternative entity managers accountable"); Larry E. Ribstein, *Partnership Governance of Large Firms*, 76 U. CHI. L. REV. 289, 290-98 (2009) [hereinafter Ribstein, *Partnership Governance*] (identifying various contractual and extra-contractual mechanisms that provide managerial accountability in large unincorporated firms in lieu of fiduciary duties); Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 546-47 (1997) (same). *But see* Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. 503, 503 (2017) (finding "little evidence . . . that the contractual freedom is used to craft systematically more efficient contractual owner protections," but instead that "LLCs with more vulnerable owners adopt significantly fewer owner safeguards, suggesting that contractual freedom may be used more often for opportunism and not for efficiency").

230. *See Neme v. Shrader*, 991 A.2d 1120, 1126 (Del. 2010) ("[W]e must . . . not rewrite the contract to appease a party who later wishes to rewrite a contract he now believes to have been a bad deal."); *id.* at 1128 ("Crafting . . . a post contracting equitable amendment that shifts economic benefits from [one contracting party to the other] would vitiate the limited reach of the [implied covenant]."); *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 441 (Del. 2005) ("Existing contract terms control . . . such that implied good faith cannot be used to circumvent the parties' bargain . . ."); *ASB Allegiance Real Estate Fund v. Scion Breckenridge Manager Member, LLC*, No. 5843-VCL, 2012 WL 1869416, at *19 (Del. Ch. May 16, 2012) (Laster, V.C.) ("The [implied covenant] should not be used to 'rewrite the contract' that a party now regards as 'a bad deal.'") (quoting *Neme v. Shrader*, 991 A.2d at 1126)); *Winshall v. Viacom Int'l, Inc.*, 55 A.3d 629, 637 (Del. Ch. Nov. 10, 2011) (Strine, C.) ("[T]he implied covenant is not a license to rewrite contractual language just because the plaintiff failed to negotiate for [better] protections . . ."); *Loneragan v. EPE Holdings, LLC*, 5 A.3d 1008, 1025 (Del. Ch. 2010) (Laster, V.C.) ("[B]ecause the LP Act specifically authorizes the elimination of fiduciary duties, this Court must act with 'caution and restraint' and decline to use the implied covenant as a basis for 'ignoring the clear language' of Section 1101(d) and the Holdings LP Agreement." (quoting *Stroud v. Grace*, 606 A.2d 75, 87 (Del. 1992))); *Related Westpac LLC v. JER Snowmass LLC*, No. 5001-VCS, 2010 WL 2929708, at *6 (Del. Ch. July 23, 2010) (Strine, V.C.) ("[Plaintiff] seeks for me to imply a condition . . . that was expressly excluded by the terms of the contract! Delaware Law respects the freedom of parties in commerce to strike bargains . . . and enforces those bargains as plainly written."); *Frontier Oil Corp. v. Holly Corp.*, No. Civ.A. 20502, 2005 WL 1039027, at *28 (Del. Ch. Apr. 29, 2005) (Noble, V.C.) ("The Court, of course, may not substitute its notions of fairness for the terms of the agreement reached by the parties."); *see also Klig v. Deloitte LLP*, 36 A.3d 785, 797 (Del. Ch. 2011) (Laster, V.C.) ("[The implied covenant] does not empower the Court to impose on the parties its own view of what would be fair or reasonable."); *cf. Strine & Laster, supra* note 233, at 26 ("[T]he potential expansion in the role of the implied covenant could render contractual expectations less predictable, thereby raising the cost of contracting and deterring the formation of some relationships.").

231. *See Manesh, Express Terms, supra* note 187, 32-38 (describing the equitable discretion involved in applying the implied covenant of good faith and fair dealing).

232. *See id.* at 3; *see also* DEL. CODE ANN. tit. 6, § 18-1101(c) (2016) (prohibiting waiver of the implied covenant of good faith and fair dealing in LLC agreements); *id.* § 17-1101(d)

the same reasons, Delaware courts are right to be exceedingly wary to deploy their constitutionally protected equitable powers to override the express terms of an LLC agreement. Consequently, the judicial use of that power may be limited to cases where the circumstances presented, although perhaps contemplated in general terms, are not specifically and explicitly addressed by the LLC agreement, and therefore, the express contractual right or obligation at issue is itself not fully determinate.²³³

(prohibiting waiver of the implied covenant of good faith and fair dealing in limited partnership agreements); *id.* § 15-103(f) (prohibiting waiver of the implied covenant of good faith and fair dealing in general partnership agreements).

233. Both *Haley* and *Carlisle* fit this criterion. In *Haley*, although the LLC agreement provided for a detailed exit mechanism in the event a member desired to leave the business, the detailed provisions did not specifically address the unusual facts of the case, namely what should happen where the member wishing to exit is also a bound by a personal guaranty to a third party on behalf of the business. *See Haley v. Talcott*, 864 A.2d 86, 92 (Del. Ch. 2004). Likewise, in *Carlisle*, although the LLC statute did not grant standing to the LLC interest assignee to seek judicial dissolution, neither the statutory provision nor the simple form LLC agreement used by the parties specifically addressed the unusual facts of that case, namely what should happen where, due to the parties' informality, neither the assignee nor assignor qualified as a member and were, therefore, left powerless in the business's governance contrary to the parties' original expectations. *See In re Carlisle Etcetera LLC*, 114 A.3d 592, 606 (Del. Ch. 2015).

Applying this criterion to limit equitable intervention to only those cases where the relevant statutory or contract provisions do not specifically and explicitly address the circumstances presented is consistent with the suggestion that equity acts a 'gap-filler' where the parties' agreement is otherwise silent. *See, e.g., Jowers & Adams, supra* note 122, at 1, 4. In this respect, to the extent the courts limit the exercise of their equitable powers to only cases where the relevant statutory or contract text is silent to the specific circumstances presented, the role of equity will be akin to the role of the implied contractual covenant of good faith and fair dealing which is likewise a judicial gap-filler. *See Manesh, Express Terms, supra* note 187, at 20-43. The difference will be that the courts can be more explicit about considerations of fairness and justice, and therefore more aggressive, when exercising their equitable powers. *Cf. Leo E. Strine, Jr., & J. Travis Laster, The Siren Song of Unlimited Contractual Freedom in RESEARCH HANDBOOK ON PARTNERSHIPS, LLCs AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11, 25-27* (Robert W. Hillman & Mark J. Loewenstein eds., 2015) (expressing concern that in the face of fiduciary waivers courts may be tempted to bend the implied contractual covenant of good faith and fair dealing to achieve justice in particularly egregious cases).

In identifying gaps in an LLC agreement, courts are aided by two doctrines. The first is the doctrine of *contra proferentem*, interpreting ambiguous provisions of an LLC agreement against the drafting party, often the manager or controlling member of the LLC. *Cf. Norton v. K-Sea Transp. Partners, L.P.*, 67 A.3d 354, 360 (Del. 2013) ("If the contractual language at issue is ambiguous and if the limited partners did not negotiate for the agreement's terms, we apply the *contra proferentem* principle . . ."); *In re Nantucket Island Assocs. Ltd. P'ship Unitholders Litig.*, 810 A.2d 351, 361 (Del. Ch. 2002) (Strine, V.C.) (applying *contra proferentem* to interpret ambiguity in a limited partnership agreement "drafted almost exclusively by the[] founding general partners—or perhaps more accurately, by the lawyers for the[] founding general partners"). The second is the principle that any contractual waiver of fiduciary duties must be explicit and unambiguous. *See, e.g., Feeley v. NHAOCG, LLC*, 62 A.3d 649, 664 (Del. Ch. 2012) (Laster, V.C.) ("Drafters of an LLC agreement 'must make their intent to eliminate fiduciary duties plain and unambiguous.' " (quoting *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, No. 3658-VCS, 2009 WL

Related to the importance of certainty in business law, there is a second, more pragmatic reason to believe the chancery court will exercise its constitutional equity jurisdiction sparingly, in only the most exceptional, compelling cases. Delaware, as a state, draws enormous—and growing—revenues due to its popularity as the legal home to hundreds of thousands of LLCs.²³⁴ And over the last decade, while the percentage of the state's annual revenue derived from corporate franchise taxes has been flat, an increasingly larger portion of the state's annual revenue has been derived from the taxes paid by LLCs organized in Delaware.²³⁵

Business planners and their attorneys nationally are drawn to Delaware's LLC law principally because of the perceived certainty and contractual freedom it affords, including the freedom to modify or eliminate fiduciary duties.²³⁶ If the chancery court were to routinely use its constitutionally protected equitable power to override the express terms of LLC agreements in anything other than the most exceptional and compelling circumstances, then it would undermine this key attraction of the state and jeopardize Delaware's lucrative LLC tax base.

Even if Delaware's judges are insensitive to this fact, Delaware's political actors will undoubtedly be more pragmatically minded.²³⁷ And while exercising equitable discretion is a judicial question, amending the state constitution to strip the courts of that discretion is a political question that can be decided on purely pragmatic considerations.²³⁸ Mindful that their constitutional power to do equity will be jeopardized by the imprudent use of that power, Delaware jurists are likely to limit

1124451, at *9 (Del. Ch. Apr. 20, 2009) (Strine, V.C.)); *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, No. 5502-C5, 2011 WL 3505355, at *31 (Del. Ch. Aug. 8, 2011) (Strine, C.) (“Although Delaware’s [LP statute] permits the waiver of fiduciary duties, such waivers must be set forth clearly”); *Kelly v. Blum*, No. 4516-VCP, 2010 WL 629850, at *10 n.70 (Del. Ch. Feb. 24, 2010) (Parsons, V.C.) (“Having been granted great contractual freedom by the LLC Act, drafters of and parties to an LLC agreement should be expected to provide . . . clear and unambiguous provisions when they desire to expand, restrict, or eliminate the operation of traditional fiduciary duties.”); *Sonet v. Timber Co., L.P.*, 722 A.2d 319, 322 (Del. Ch. 1998) (Chandler, C.) (“[P]rinciples of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain.”).

234. See Manesh, *Market for LLC Law*, *supra* note 2, at 200-04.

235. See *id.* at 197-204.

236. See Franklin A. Gevurtz, *Why Delaware LLCs?*, 91 OR. L. REV. 57, 105 (2012) (reporting the results of interviews with business attorneys about their preference for Delaware LLC law); see also *supra* note 227.

237. See Manesh, *Damning Dictum*, *supra* note 144, at 67 (citing other examples of the Delaware legislature's alacrity to promptly correct problematic judicial precedents).

238. The Delaware state constitution may be modified in one of two ways, both of which can be initiated solely by the Delaware General Assembly. See Johnson, *supra* note 22, at 714 n.70.

the use of equity to override contract to only the most compelling circumstances. Despite *Carlisle*, cases like *Haley* will be exceptional, not the rule in LLC jurisprudence.²³⁹

B. Publicly Traded LLCs and Limited Partnerships

Even if Delaware courts are appropriately reluctant to exercise their constitutionally protected equitable powers to override the express terms of an LLC agreement, publicly traded LLCs, and their limited partnership ilk, could prove to be a special exception. The vast majority of publicly traded businesses are organized as corporations, in which, as noted above, investors are protected by the unwaivable fiduciary duties owed by corporate officers and directors.²⁴⁰ But some 150 publicly traded businesses are unincorporated²⁴¹—LLCs or, more commonly, limited partnerships—almost always organized under Delaware law.²⁴²

Delaware limited partnership law is in many respects identical to its LLC law.²⁴³ In fact, Delaware's LLC statute was modeled on the state's limited partnership statute,²⁴⁴ including its express commitment to the "freedom of contract."²⁴⁵ Exercising this freedom, the agreements governing publicly traded LLCs and limited partnerships commonly contain terms eliminating the fiduciary duty of loyalty, replacing that equitable duty with less rigorous contractual obligations.²⁴⁶ And in deference to the statutorily mandated freedom of

239. See, e.g., *Trusa v. Nepo*, No. CV 12071-VCMR, 2017 WL 1379594, at *8 (Del. Ch. Apr. 13, 2017) (Montgomery-Reeves, V.C.) (asserting that the equitable power recognized in *Carlisle* is an "extreme" measure "that should be granted sparingly"). Note, in many circumstances, the Delaware courts may achieve equitable results without even appealing to their constitutional equitable powers. The courts might rely instead on established contract law doctrines of *contra proferentem* or the implied covenant of good faith and fair dealing. See *supra* note 233.

240. See *supra* note 53 and accompanying text.

241. See Master Limited Partnership Association, *List of Current MLPs & MLP Funds* (2016), <http://www.mlpassociation.org/wp-content/uploads/2015/08/MLP-LIST.pdf>.

242. See Manesh, *Contractual Freedom*, *supra* note 53, at 598 n.236.

243. See *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 290-92 (Del. 1999) (comparing the similarities between the Delaware LLC and limited partnership statutes); *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, No. 3658-VCS, 2009 WL 1124451, at *9 n. 43 (Del. Ch. Apr. 20, 2009) (Strine, V.C.) ("[I]n the absence of developed LLC case law, this court has often decided LLC cases by looking to analogous provisions in limited partnership law.")

244. See *Elf Atochem*, 727 A.2d at 290 ("The Delaware [LLC] Act has been modeled on the popular Delaware [Limited Partnership] Act. In fact, its architecture and much of its wording is almost identical to that of the Delaware [Limited Partnership] Act. Under the [LLC] Act, a member of an LLC is treated much like a limited partner" (footnotes omitted)).

245. DEL. CODE ANN. tit. 6, § 17-1101(c) (2016).

246. See Manesh, *Contractual Freedom*, *supra* note 53, at 574-96 (reporting empirical evidence showing that 88% of publicly traded LLCs and limited partnerships fully eliminate or exculpate the fiduciary duties of their managers); Strine & Laster, *supra* note 233,

contract, Delaware courts have, in case after case, enforced these agreements, dismissing lawsuits brought by public investors alleging bad faith or self-dealing on the part of the parties managing or controlling the business.²⁴⁷

In enforcing contractual fiduciary waivers in the context of a publicly traded LLC or limited partnership, however, the courts have sometimes paused to observe the inequity of the situation.²⁴⁸ After all, the agreements governing these businesses bear all the hallmarks of contracts of adhesion: prolix and confusing, often unread and unnegotiated, offered on a take-it-or-leave-it basis, and frequently stuffed full of terms that favor the drafting party (the firm's managers and sponsors) at the expense of sometimes unsophisticated public investors.²⁴⁹ Thus, in *Encore Energy*, for instance, after finding the "near absence under the [LP agreement] of any duties whatsoever [owed] to [the] public equity holders," Vice Chancellor Parsons observed in dictum that "[i]nvestors apprehensive about the risks inherent in waiving the fiduciary duties of those with whom they entrust their investments may be well advised to avoid [publicly traded] limited partnerships."²⁵⁰ And on appeal, the Delaware Supreme Court likewise cautioned public investors "seek[ing] the protections the common law duties of loyalty

at 12 (observing, from a judicial perspective, that "[a]mong the hallmarks of these agreements [governing publicly traded LLCs and limited partnerships] are broad waivers of all fiduciary duties").

247. See, e.g., *Wood v. Baum*, 953 A.2d 136, 139 (Del. 2008); *Dieckman v. Regency GP LP*, No. 11130-CB, 2016 WL 1223348 (Del. Ch. Mar. 29, 2016); *In re Kinder Morgan, Inc. Corp. Reorg. Litig.*, No. 10093-VCL, 2015 WL 4975270 (Del. Ch. Aug. 20, 2015), *aff'd*, No. 515, 2015, 2016 WL 912184 (Del. Mar. 10, 2016); *Gerber v. EPE Holdings, LLC*, No. 3543-VCN, 2013 WL 209658 (Del. Ch. Jan. 18, 2013); *In re Encore Energy Partners LP Unitholder Litig.*, No. 6347-VCP, 2012 WL 3792997 (Del. Ch. Aug. 31, 2012), *aff'd*, 72 A.3d 93 (Del. 2013); *In re K-Sea Transp. Partners L.P. Unitholders Litig.*, No. 6301-VCP, 2012 WL 1142351 (Del. Ch. Apr. 4, 2012), *aff'd*, 67 A.3d 354, 360-61 (Del. 2013); *Brinckerhoff v. Enbridge Energy Co., Inc.*, No. 5526-VCN, 2011 WL 4599654 (Del. Ch. Sept. 30, 2011), *aff'd*, 67 A.3d 369 (Del. 2013).

248. See, e.g., *Dieckman*, 2016 WL 1223348, at *11 (Bouchard, C.) ("I recognize it may seem harsh to shield a conflicted transaction from judicial review . . . without requiring the disclosure of all material information."); *Gerber v. EPE Holdings, LLC*, No. 3543-VCN, 2013 WL 209658, at *10 (Del. Ch. Jan. 18, 2013) (Noble, V.C.) ("It is not difficult to understand [the plaintiff-investor's] skepticism and frustration, but his real problem is the contract that binds him and his fellow limited partners."); *Gerber v. Enter. Prods. Holdings, LLC*, No. 5989-VCN, 2012 WL 34442, at *13 (Del. Ch. Jan. 6, 2012) (Noble, V.C.) ("The facts of this case take the reader and the writer to the outer reaches of conduct allowable under [Delaware law]. It is easy to be troubled by the allegations.");

249. See *Strine & Laster*, *supra* note 233, at 11-13; see also *Manesh, Legal Asymmetry*, *supra* note 53, at 482-84 (questioning the assumptions underlying the contractual conception of LLCs and limited partnerships for publicly traded firms).

250. *In re Encore Energy Partners LP Unitholder Litig.*, No. 6347-VCP, 2012 WL 3792997, at *13 (Del. Ch. Aug. 31, 2012) (Parsons, V.C.).

and care provide . . . to invest in a Delaware corporation” rather than an LLC or limited partnership.²⁵¹

Sounding their own skepticism about the freedom of contract as applied to publicly traded LLCs and limited partnerships, Chief Justice Strine joined by Vice Chancellor Laster, in a recently co-authored book chapter,²⁵² have bemoaned the ability of these businesses to contractually eliminate all fiduciary obligations that would otherwise be owed to public investors.²⁵³ To address this problem, the two jurists have proposed amending Delaware’s alternative entity statutes to make the fiduciary duty of loyalty mandatory—contractually unwaivable—for publicly traded LLCs and limited partnerships.²⁵⁴

But the upshot of *Carlisle* is that the Delaware Chancery Court already possesses the constitutional power to enforce the fiduciary duty of loyalty notwithstanding the express terms of an agreement purporting to waive that duty.²⁵⁵ While an amendment to Delaware’s statutes would lend the courts the legislature’s imprimatur, under the reasoning of *Carlisle*, such an amendment is unnecessary as a strictly constitutional matter.

To be sure, the chancery court’s assertion of its constitutional power to override the statutorily mandated freedom of contract risks a confrontation between the state judiciary and the Delaware General Assembly. As noted above, the state’s pragmatically minded legislators will be sensitive to any judicial decision that potentially imperils the state’s thriving LLC and limited partnership tax base.²⁵⁶ But, in the narrow context of publicly traded LLCs and limited partnerships, the legislature might be less concerned by the courts’ assertion of equity to override the express terms of an agreement. Because the vast majority of Delaware LLCs and limited partnerships are privately held, the approximately 150 publicly traded unincorporated businesses represent only a very small slice of Delaware’s alternative entity tax base.²⁵⁷ Together, these publicly traded unincorporated businesses contribute approximately \$45,000 (or less than 0.0002%) of

251. *Allen v. Encore Energy Partners, LP*, 72 A.3d 93, 109 (Del. 2013).

252. *See generally* Strine & Laster, *supra* note 233.

253. *See id.* at 11-13.

254. *See* Strine & Laster, *supra* note 233, at 13 (proposing that “[f]or publicly traded entities, the duty of loyalty would be non-waivable”).

255. *See supra* note 131 and accompanying text.

256. *See supra* notes 234-38 and accompanying text.

257. *See* Manesh, *Contractual Freedom*, *supra* note 53, at 571-72. For scale, consider that, in 2014 alone, 121,592 LLCs and 9,721 limited partnerships were formed in Delaware. *See* JEFFREY W. BULLOCK, DEL. DIV. OF CORPS., 2014 ANNUAL REPORT 2 (2015), https://corp.delaware.gov/Corporations_2014%20Annual%20Report.pdf [<https://perma.cc/X8EZ-WHBV>].

Delaware's nearly \$244.4 million received in annual taxes from its domestic LLCs and limited partnerships.²⁵⁸ As a result, judicial rulings that are perceived to adversely affect only Delaware's publicly traded LLCs and limited partnerships are less likely to raise the ire of the state's General Assembly.

Note, however, that even in the narrow context of publicly traded LLCs and limited partnerships, there are reasons the chancery court ought to be reluctant in asserting its equitable power over the express terms of the firm's governing agreement. For one, equitable power should be deployed only where a litigant lacks an adequate remedy at law.²⁵⁹ The public investors of an LLC or limited partnership might well have adequate options for legal redress, even in the face of a governing agreement unilaterally drafted to be protective of those managing or otherwise in control of the business.²⁶⁰ An adequate remedy at law—namely money damages—might arise from a claim for breach of the express terms of that agreement.²⁶¹ Even where there is no breach of the express contract terms, an adequate legal remedy might arise from a claim for breach of the implied contractual covenant of good faith and fair dealing,²⁶² which is implied

258. Domestic LLCs and limited partnerships—whether publicly traded or privately held, and regardless of profits, revenue or size—pay Delaware an annual flat tax of \$300 for the simple privilege of being organized under Delaware law. *See* DEL. CODE ANN. tit. 6, § 18-1107(b) (2016) (LLCs); *id.* § 17-1109(a) (limited partnerships). In 2015, Delaware received in total \$244.4 million in annual taxes from its domestic LLCs and limited partnerships. *See* DEL. OFFICE OF MGMT. & BUDGET, FINANCIAL SUMMARY: GOVERNOR'S RECOMMENDED BUDGET: FISCAL YEAR 2017, at 8 (2016), <http://budget.delaware.gov/budget/fy2017/documents/operating/vol1/financial-summary.pdf>. For an analysis of Delaware's flat tax structure for LLCs and limited partnerships, see generally Manesh, *Market for LLC Law*, *supra* note 2, at 204-10.

259. *See supra* notes 141-42 and accompanying text (explaining this principle of equity jurisprudence).

260. *See, e.g., In re Atlas Energy Res., LLC*, No. 4589-VCN, 2010 WL 4273122, at *8 (Del. Ch. Oct. 28, 2010) (ruling that a contractual provision waiving all conflicts of interest between the LLC and its controlling unitholder does not waive the duty of loyalty as it applies to a conflict of interests between the controlling unitholder and the LLC's minority unitholders); *Kahn v. Portnoy*, No. 3515-CC, 2008 WL 5197164, at *4 (Del. Ch. Dec. 11, 2008) (ruling that a contractual provision waiving all conflicts of interests between the LLC's managers and its unitholders does not waive the duty of loyalty as it applies to a conflict of interests between the LLC's managers and the LLC itself).

261. *See, e.g., In re El Paso Pipeline Partners*, No. 7141-VCL, 2015 WL 1815846, at *27 (Del. Ch. Apr. 20, 2015) (awarding judgment for damages against general partner for breach of express contractual duty).

262. *See, e.g., Gerber v. Enter. Products Holdings, LLC*, 67 A.3d 400, 425 (Del. 2013) (holding that plaintiff-investor stated a valid claim based on the implied contractual covenant against the managers of a publicly traded limited partnership).

into every contract²⁶³ and unwaivable under both LLC and limited partnership statutes.²⁶⁴

Importantly, however, a party does *not* have an adequate legal remedy simply because that party *could have* better protected itself *ex ante* in the terms of the LLC or limited partnership agreement.²⁶⁵ To be sure, a party's voluntary assent to an agreement that leaves that party vulnerable to later actions that were reasonably foreseeable and could have easily be contractually proscribed *ex ante* weighs against the court's use of equitable discretion to protect that party *ex post facto*. Equity protects the vigilant, after all.²⁶⁶ But the fact that a party failed to protect herself *ex ante* alone cannot mean that the party has an adequate remedy at law; otherwise, equity would have virtually no role to play in the world of business associations, where the relationships between the entity, its investors, and managers are created by consent, and the parties arguably always possess the ability to protect themselves *ex ante*.²⁶⁷

A second reason that courts should be chary to equitably intervene in the context of publicly traded LLCs and limited partnerships is that various market-based considerations associated with these entities weigh against the judicial use of equitable discretion to protect investors. For example, even if the agreements governing publicly traded LLCs and limited partnerships are prolix and confusing, public investors benefit under federal securities law from extensive and explicit disclosures of the business and legal risks involved.²⁶⁸ And the securities purchased by these investors have been priced by a liquid market that is at least to some degree efficient, meaning that the terms of the

263. See *supra* note 187; see also *supra* note 233 (comparing judicial application of the implied contractual covenant versus equity).

264. See DEL. CODE ANN. tit. 6, § 17-1101(d) (2016) (governing limited partnerships); *id.* § 18-1101(c) (governing LLCs).

265. But see CML V, LLC v. Bax, 28 A.3d 1037, 1046 (Del. 2011) (asserting that because the plaintiff “could have negotiated a contractual remedy at law” but did not, the plaintiff “has ample remedy at law”).

266. POMEROY, *supra* note 1, § 418, at 169. Although this maxim of equity is ordinarily used to mean that equity will not aid those who have slept on their rights in pursuing a valid claim, it can be generalized to support the proposition that equity will not reward those who were slothful or negligent in protecting themselves.

267. Consider, for example, *Haley v. Talcott*, 864 A.2d 86, 98 (Del. Ch. 2004), where then-Vice Chancellor Strine granted judicial dissolution because the “detailed exit” mechanism contemplated by the relevant LLC agreement “fails as an adequate remedy for Haley because it does not equitably effect the separation of the parties.”

268. See, e.g., STEPHON J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS, 89-99, 191-93 (Thompson & Foundation Press eds., 2d ed. 2008) (describing the mandatory disclosures required for public offerings of securities as well as from companies with publicly traded securities); *cf.* Dieckman v. Regency GP LP, No. 11130-CB, 2016 WL 1223348, at *11 (Del. Ch. Mar. 29, 2016) (observing that plaintiffs may have legal recourse under federal securities law); Lonergan v. EPE Holdings, LLC, 5 A.3d 1008, 1025 (Del. Ch. 2010) (same).

governing agreement—whether management- or investor-friendly—have already been priced into the securities that the investors bought.²⁶⁹ As a result, even if the investors in publicly traded LLC and limited partnership do not read or understand the unilaterally drafted terms that they are agreeing to by investing, and even if those terms are unduly favorable to the business’s managers and controllers, the market ensures that the public investors are getting exactly what they pay for. Indeed, given the sensitivity to markets and pricing, some evidence suggests that publicly traded LLCs and limited partnerships do not simply eliminate fiduciary duties, but replace fiduciary duties with contract- and market-based alternatives that aim to appropriately incentivize managers and protect outside investors.²⁷⁰

In light of these considerations, equitable intervention on behalf of investors in publicly traded LLCs and limited partnerships risks unfairly giving those investors more than the benefit of their bargain.²⁷¹ Thus, even in the narrow context of publicly traded unincorporated firms, the circumstances for the court to assert equity over the express terms of the governing agreement must be exceptional. The challenged conduct must be something that, although perhaps contemplated in general terms, is not specifically and explicitly permitted by the agreement governing the firm;²⁷² and, moreover, the conduct must be so peculiar, outrageous, or otherwise unforeseeable that it is doubtful the market could have priced the risk of such conduct into the value of the securities.

269. See, e.g., CHOI & PRITCHARD, *supra* note 268, at 28-29 (describing the efficient capital market hypothesis); cf. Gerber v. Enter. Products Holdings, No. 5989-VCN, LLC, 2012 WL 34442, at *10 n.42 (Del. Ch. Jan. 6, 2012) (Noble, V.C.) (observing that “[i]f the protection provided by Delaware law is scant, then the . . . units of these [publicly traded] partnerships might trade at a discount”).

270. See Suren Gomtsian, *The Governance of Publicly Traded Limited Liability Companies*, 40 DEL. J. CORP. L. 207, 225-69 (2015) (providing evidence of various contractual and non-contractual mechanisms protective of minority holders in publicly traded LLCs); cf. *supra* note 229.

271. To be sure, it may be the case that since the time of *Carlisle* the possibility of equitable intervention has been priced into the publicly traded securities of LLCs and LPs and, therefore, the price paid by subsequent purchasers of such securities has already factored in this potential. But cases like *Carlisle* may be rare enough (and, indeed, there has not yet been an analogous example in the context of publicly traded LLCs and LPs) that the market may not have yet priced it. Even if Delaware courts decide more cases along of the lines of *Carlisle*, asserting the courts’ equitable power notwithstanding the express terms of a firm’s governing agreement, and even if those cases involve a publicly traded LLC and LP, the facts and the terms at issue in any given case may be idiosyncratic enough that the market will not price such decisions into shares of other publicly traded LLCs and LPs. Manesh, *Market for LLC Law*, *supra* note 2, at 235-38 (discussing how the contractibility permitted under LLC law limits the network effects of judicial precedents).

272. See *supra* notes 221-25 and accompanying text.

VI. CONCLUSION

The lasting impact of *Carlisle* ultimately rests on how the Delaware courts approach its conflict with *Bax* and the constitutional role of equity in LLCs. As this Article has argued, *Bax*'s flawed understanding of equity,²⁷³ coupled with recent developments involving Delaware's LLC statute and judiciary,²⁷⁴ suggest that *Bax*'s future precedential value is not promising.

If *Carlisle* is indeed vindicated, then it portends a resurgent role for equity—and a fundamental crack in the seemingly solid contract-law foundations of LLCs. In practice, the consequences will be subtle, but far-reaching. Because under Delaware's unusual constitutional framework, equity cannot be subordinated by statute or contract. Only a state constitutional amendment can subordinate the judicial power to “to do right and justice.”²⁷⁵

273. See *supra* Section IV.A.

274. See *supra* Section IV.B.

275. In theory at least, an alternative route to subordinating equity to contract would be to overrule the Delaware Supreme Court's interpretation of the state constitution in *Dupont*. See *supra* note 72-76 and accompanying text. Given that this interpretation has been repeatedly reaffirmed, most recently in both *Bax* and *Carlisle*, however, a reversal of *Dupont* seems improbable. See *supra* note 129 and accompanying text.

