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# LLCs and the Private Ordering of Dispute Resolution

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## I. INTRODUCTION

An emerging question in U.S. business law is the extent to which the organizational documents of a business entity may set the rules for resolving internal disputes. Contracting about dispute resolution is a routine aspect of commercial contracting. The parties may select where disputes are resolved or specify particular aspects of dispute resolution, such as access to a jury or allocation of costs. Until recently, however, private ordering of litigation procedures within business entities was often overlooked. This changed when companies began to adopt provisions in corporate charters and bylaws that limited shareholder litigation by restricting the courts in which parties could litigate or by requiring unsuccessful plaintiffs to pay the other side's costs.

On the one hand, terms that eliminate traditional dispute resolution procedures have the benefit of reducing litigation expenses and streamlining dispute resolution, potentially making the firm more valuable. On the other hand, terms that restrict the ways in which owners can hold managers accountable could open the door to greater management agency costs that devalue the firm. The controversial use of these terms in corporations ultimately prompted a legislative response by Delaware that restricted the use of fee-shifting and mandatory arbitration clauses in Delaware stock corporations—the need to constrain agency costs and protect shareholders' access to the courts apparently outweighed the potential efficiencies that these terms promised.

Missing from this discussion is the extent to which *non-corporate* business entities set ex-ante rules for resolving disputes among their entity's constituents. Non-corporate entities bridge the two chapters in the story of the spread of provisions that alter the dispute resolution process, as they involve both explicit contracting and the use of a business form. This Article begins to map this uncharted area with an empirical study of the practice of limited liability companies (LLCs).

LLCs are a ubiquitous and growing form of business organization, with more than two million LLCs in the United States.[1] Despite the prevalence of LLCs, the terms under which they operate are largely unknown and understudied, in part because the operating agreements of privately owned LLCs are not filed or otherwise broadly available. This Article addresses this problem by using an original data set of privately owned LLC governing documents developed by one of the authors.[2] Within this body of privately owned LLC operating agreements, this Article identifies and charts terms that set the rules for resolving disputes among the LLC's constituents: members, managers, and the entity itself. In doing so, it provides a baseline for the study of dispute resolution in LLCs and the use of arbitration in this context, as well as illustrating with concrete examples the range of litigation provisions that could be used within corporations and other business entities.

The Article begins in Part II with a brief overview of the emerging use of provisions to govern disputes within business entities, particularly stock corporations. Part III details the methodology and the development of the data set. Part IV reports the results, and Part V offers implications from the analysis for the study of LLCs, corporations, and business organizations more broadly.

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1. *See* IRS, Partnership Returns, 2012 5 fig.G (Winter 2015), http://www.irs.gov/pub/irs-soi/soi-a-pa-id1504.pdf (reporting filings by 2.2 million LLCs).

2. Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. (forthcoming 2017), http://ssrn.com/abstract=2754637.

## II. THE SPREAD OF DISPUTE RESOLUTION PROVISIONS TO BUSINESS ENTITIES

Commercial and consumer contracts often include provisions that shape future litigation between the contracting parties. A fairly common example is a clause that selects an exclusive forum for the resolution of a covered dispute.[3] Other provisions alter particular procedural rules, instituting limits on discovery, setting rules about who covers litigation fees and costs, and limiting or eliminating available damages and remedies.[4]

Until recently, however, private ordering of litigation within business entities was often ignored. In the corporate context, charters and bylaws generally did not include provisions to shape intracorporate litigation. Clauses choosing the law and the forum seemed unnecessary—the internal affairs doctrine ensured that the law of the incorporation state applied to intracorporate disputes, and suits by tradition were filed in the state of incorporation.[5]

Things changed in the early 2000s. The emergence of multiforum mergers and acquisitions (M&A) litigation sparked interest in shaping shareholder litigation through terms in corporate organizational documents. Shareholder suits challenging corporate deals were increasingly filed outside the state of incorporation, often in multiple states at once.[6] A prominent solution to this perceived problem—advocated by judges, lawyers, and scholars—was to add an exclusive forum selection clause to the corporate charter or bylaws that would limit the jurisdictions in which litigation could be brought.[7]

In 2013, the Delaware Chancery Court explicitly approved these exclusive forum clauses, finding such a bylaw to be facially valid in *Boilermakers v. Chevron*.[8] Corporations have since increasingly adopted these clauses in corporate charters and bylaws.[9] Their use and acceptance also laid the groundwork for another type of dispute

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3. *See* Theodore Eisenberg & Geoffrey P. Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1981 (2006) (finding that 53% of merger and acquisition agreements from 2002 included a choice of forum); Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1475, 1478 (2009) (showing that 39% of 2882 material contracts of reporting companies studied in 2002 designated forum).

4. *See* Colter L. Paulson, *Evaluating Contracts for Customized Litigation by the Norms Underlying Civil Procedure*, 45 ARIZ. ST. L.J. 471, 473 (2013).

5. Verity Winship, *Shareholder Litigation by Contract*, 17 B.U. L. REV. (forthcoming 2016), http://ssrn.com/abstract=2575668.

6. John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605, 642 (2012); *see also* Jennifer Johnson, *Securities Class Actions in State Court*, 80 U. CIN. L. REV. 349, 374, fig.8 (2012) (reporting that state-court deal litigation in 2010 was often filed outside the state of incorporation); Minor Myers, *Fixing Multi-Forum Shareholder Litigation*, 2014 U. ILL. L. REV. 467 (identifying and addressing the issue of suits filed simultaneously in several fora); Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2011* (Feb. 2, 2012), http://ssrn.com/abstract=1998482 (reporting that half of takeover transactions were challenged by suits filed in multiple states).

7. *In re* Revlon Inc. S'holders' Litig., 990 A.2d 940, 960 n.8 (Del. Ch. 2010); Ted Mirvis, *Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, M&A J. (2007); Joseph A. Grundfest, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches (The 2010 Pileggi Lecture)* 2 (Rock Center for Corporate Governance, Stanford University Working Paper No. 91, 2010), http://ssrn.com/abstract=1690561.

8. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 956 (Del. Ch. 2013).

9. *See* Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation* 66 (ECGI Working Paper Series in Law, Working Paper No. 295/2015, June 2015),

resolution provision: fee-shifting. In May 2014, the Delaware Supreme Court held an aggressively drafted fee-shifting bylaw facially valid in *ATP Tour v. Deutscher Tennis*.[10] This decision led to lobbying, legislation, and debate on the wisdom of allowing corporations to curtail shareholder suits.[11]

Ultimately, legislation was passed in Delaware in 2015 to limit the spread of fee-shifting provisions.[12] The statutory response prohibits Delaware stock corporations from adding fee-shifting provisions to their charter or bylaws. At the same time, the legislation sanctions use of exclusive forum clauses, allowing Delaware corporations to include such terms, so long as they do not exclude Delaware courts as a permissible forum.[13]

These developments suggest no impending end to the debate over respecting companies' private ordering solutions on the one hand, while protecting less sophisticated investors via mandatory rules on the other. Yet, because separate statutes govern separate classes of business organizations, the current debate over protecting the business law litigation process has a gaping hole. Judicial and statutory responses—aimed specifically at corporations—do not spill over to their non-corporate partnership and LLC counterparts. Delaware's exclusive forum and fee-shifting legislation reaches only stock corporations, leaving partnerships and LLCs unaffected by these limitations, despite the similar importance of the dispute resolution process for investors in these entities.

The gap in the debate is unfortunate. Non-corporate entities not only account for a significant portion of business entities and national commerce,[14] but they also provide a missing connection between the use of dispute resolution provisions in commercial contracts and in the organizational documents of business entities. LLC statutes similar to Delaware's reflect a fundamental commitment to private ordering and freedom of contract.[15] Ignoring how dispute resolution terms are employed in this permissive environment misses a valuable perspective from the frontier of organizational law.

Moreover, an often overlooked aspect of the arguments in the corporate context is

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http://ssrn.com/abstract=2622595 (finding that 746 public companies had adopted such clauses and noting an 80% probability of an exclusive forum clause at the IPO stage); *see also* Joseph A. Grundfest, *The History and Evolution of Intra-Corporate Forum Selection Clauses: An Empirical Analysis*, 37 DEL. J. CORP. L. 333, 339 (2012) (providing data on increased forum selection clause use); *see generally* Jared I. Wilson, *The Value of Venue in Corporate Litigation: Evidence from Exclusive Forum Provisions* (Aug. 2015), http://ssrn.com/abstract=2646312 (assessing the effect of exclusive forum clauses on shareholder value).

10. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 555 (Del. 2014); Deutscher Tennis Bund v. ATP Tour Inc., 480 F. App'x 124, 126 (3d Cir. 2012) (quoting Article 23 of the Amended and Restated Bylaws of ATP Tour, Inc. (adopted on Oct. 22, 2006)).

11. *See* Winship, *supra* note 5, at 4 (discussing the ensuing developments); *see generally* Verity Winship, *Contracting Around Securities Litigation: Some Thoughts on the Scope of Litigation Bylaws*, 68 SMU L. REV. 913 (2015) (analyzing the effect of dispute resolution bylaws on securities litigation).

12. S.B. 75, 148th Gen. Assemb., 1st Reg. Sess. (Del. 2015), signed into law June 24, 2015, effective Aug. 1, 2015.

13. *See id.* (adding DGCL § 115). Section 115 also prevents Delaware stock corporations from including mandatory arbitration clauses in their charter or bylaws. *See id.* § 5 (noting that DGCL section 115 would "invalidate[] such a provision selecting the courts in a different State, or an arbitral forum, if it would preclude litigating such claims in the Delaware courts").

14. *See supra* note 1 (discussing number of LLCs); IRS, Statistics of Income, *Corporate Returns, 2011*, Fig. I, http://www.irs.gov/pub/irs-soi/11coccr.pdf (identifying 1.6 million active corporations); Rodney D. Chrisman, *LLCs Are the New King of the Hill*, 15 FORD. J. CORP. & FIN. L. 459, 460 (2010) (estimating that the number of new LLCs outpaces new corporations by a two to one margin).

15. DEL CODE tit. 6, § 18-1102(b) (2015).

their reliance on developments within the non-corporate space. According to the Delaware Chancery Court, the exclusive forum corporate bylaws at issue in *Boilermakers v. Chevron* could not "fairly be argued to regulate a novel subject matter: the plaintiffs ignore that, in the analogous contexts of LLC agreements and stockholder agreements, the [Delaware] Supreme Court and this court have held that forum selection clauses are valid."[16] A richer understanding of non-corporate entities bolsters these arguments.

However, despite isolated cases in which LLCs and similar non-corporate organizations have altered dispute resolution provisions, no systematic inquiry has been undertaken into how LLC governing documents structure the dispute process.[17] We remedy this oversight. We provide an empirical study of intrafirm dispute resolution provisions adopted by LLCs, revisiting this category of private ordering in light of changes in corporate law and practices. Using an original data set developed by one of the authors,[18] this Article charts the use of provisions in privately owned LLC operating agreements—the LLC functional analogue of corporate charters and bylaws—to set the rules for resolving disputes among the LLC's constituents.

## III. METHODOLOGY

Unlike publicly traded corporations, privately held LLCs are generally not required to make their operating agreements available for public inspection. One could address this issue by studying only publicly traded LLCs, whose governing documents are made public pursuant to regulatory requirements,[19] but the number of such entities is a mere handful,[20] and analyzing such an unrepresentative sample risks providing few generalizable lessons. We therefore choose to examine privately held LLCs. Their operating agreements are made publicly available in two circumstances: when a publicly traded company is party to a material agreement and must disclose it pursuant to SEC requirements,[21] and when the agreement is included as an exhibit to litigation. Although the former option can yield a number of operating agreements,[22] this study takes the latter approach in the belief that it generates a sample more representative of LLCs as a whole.[23]

16. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 953 (Del. Ch. 2013); *see also In re* Revlon Inc. S'holders' Litig., 990 A.2d 940, 960 & n.8 (Del. Ch. 2010) (citing Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286 (Del. 1999); Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1153 (Del. Ch. 2006)) (pointing to judicial opinions that approved forum selection provisions in the LLC context in support of their use in corporations).

17. *See generally* Molk, *supra* note 2 (analyzing the few prior empirical studies of LLC provisions, none of which examined dispute resolution provisions).

18. *Id.*

19. Publicly traded LLCs must disclose their operating agreement in the annual Form 10-K filing. 17 C.F.R. § 229.601(b)(3)(i) (2014) (requiring filing articles of incorporation or the non-corporate equivalent).

20. Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law*, 37 J. CORP. L. 555, 567 (2012) (finding twelve publicly traded LLCs).

21. Regulation S-K, 17 C.F.R. § 229.601(b)(2) (2014).

22. Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 898–99 (2012) (using LLC operating agreements attached to public filings to analyze contractual fiduciary duty protections); Suren Gomtsian, *Contractual Mechanisms of Investor Protection in Non-Listed Limited Liability Companies*, 60 VILL. L. REV. 955 (2015) (employing the same approach to study an expanded set of non-litigation terms).

23. For further discussion of the comparative strengths of the approach we adopted, see Molk, *supra* note 2.

The process through which operating agreements were obtained is described in full elsewhere,[24] but we provide the essential details here. The sample of operating agreements was identified by querying the Bloomberg Law Delaware state court opinions and docket databases for the phrase "operating agreement" where at least one party to the action was an LLC. The search resulted in approximately 1000 case listings. When reviewed, operating agreements were excluded (i) if they related to a single-member LLC; (ii) if they dated before 1997, when tax reform provided LLCs with significantly greater contractual flexibility without losing partnership tax treatment;[25] (iii) if the mutual assent of their terms was contested, as when one party claimed the agreement was never executed; and (iv) if several substantially identical operating agreements were executed among the same parties, in which case only one agreement was included to avoid overrepresenting the terms of the agreement. The sample was also limited to operating agreements for LLCs organized in Delaware. The process was then re-run for a sample of cases filed in New York court that nevertheless included operating agreements of Delaware LLCs. Although all LLC agreements were disclosed in the course of litigation, many of them were not the direct subject of the litigation itself, as when a creditor seeks to collect from a member's LLC interest.

This process produced an analytical sample of 233 Delaware operating agreements. The firms represented by these operating agreements varied in both size and industry. Of the sample, 34% had two members and 44% had three to five members.[26] The industry in which the LLCs operated varied, with the highest percentages in real estate and rentals (23%) and finance and insurance (14%). For this study, each operating agreement was then reviewed to identify terms that govern the resolution of intrafirm disputes. The results of this analysis are presented below.

## IV. EMPIRICAL RESULTS: DISPUTE RESOLUTION PROVISIONS IN LLC OPERATING AGREEMENTS

The study captures provisions in the LLC operating agreements that set the rules for resolving internal disputes. The terminology about such provisions is unsettled.[27] For convenience, this Article often refers to "dispute resolution provisions," which we define broadly. It includes core litigation-related provisions that shape litigation's location (e.g., exclusive forum clauses) or process (e.g., jury waivers). The category is also broad enough to include provisions that are arguably procedural (e.g., choice of law), that affect both dispute resolution and other aspects of the internal governance of the entity (e.g., access to books and records), or that choose a non-litigation route to dispute resolution (e.g., mandatory arbitration clauses).

The focus is on intrafirm disputes. In the LLC context, the relevant actors are the

24. *See* Molk, *supra* note 2 (describing the technique).

25. IRS, INTERNAL REVENUE MANUAL § 4.61.5, http://www.irs.gov/irm/part4/irm_04-061-005.html (implementing "check the box" regulations).

26. The range was from two to well over a thousand members. Thirteen percent of the sample had ten or more members. The number of members does not reflect whether members were themselves individuals, corporations, or other business entities.

27. *See* Winship, *supra* note 11, at n.3 (noting that the corporate law literature uses the phrases "litigation provisions," "litigation-regulating" provisions or "litigation rights"); Winship, *supra* note 5, at nn.2–3 (pointing to procedural literature that refers to this practice as "contract procedure" or "party rulemaking").

constituents of the LLC: the member-owners, the managers, and the entity itself. Only the parties to the operating agreement are bound to its terms, so an operating agreement's terms bind member-owners, managers, and the entity,[28] but not third parties like external creditors. This Part reports the prevalence of various terms that shape the dispute resolution process. These results are presented for the sample as a whole, as well as for relevant subsamples.

We chose to present many of the provisions separately for LLCs that do and do not eliminate or exculpate the fiduciary duties of both care and loyalty. Occasionally members may sue managers or other members for more overt misbehavior like intentionally violating terms of the operating agreement. To the extent that members enforce their rights through suits alleging fiduciary duty violations, however, fiduciary duty waivers or exculpation might effectively eliminate members' incentive to bring these suits and therefore reduce the need to shape dispute resolution terms. We consider the differences for LLCs with and without fiduciary duty waivers or exculpations at the end of this Part.

### *A. Choice of Law*

As noted above, the data set was limited to LLCs organized in Delaware. Delaware law provides for the default application of Delaware law to the internal affairs of the LLC, applying a choice of law principle akin to the corporate internal affairs doctrine.[29] Despite this default choice of law, the vast majority (99%) of LLC operating agreements in the sample specified the applicable law. The labels for these clauses varied, and included "governing law," "choice of law," and "applicable law," but the clauses were functionally equivalent.[30] Most of the clauses (97% of the whole sample) elected Delaware law, which duplicates the law that would apply by default. Another 2% of the sample included a choice-of-law clause that elected non-Delaware law.[31] It may not be surprising that, once having decided to form within Delaware, most LLCs elected to have Delaware law apply—after all, why otherwise form within the state? On the other hand, Delaware does not command a premium price for LLC formations like it does with corporations, so parties conceivably could form within Delaware for convenience while choosing another state's law to apply with no adverse financial consequences.[32]

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28. By statute, the LLC entity itself is bound, as are members, managers, or assignees of LLC interests even if they did not execute the agreement. DEL. CODE tit. 6, § 18-101 (2015).

29. *See* 2 RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES § 13:4 (2010) (discussing conflict of laws in LLCs).

30. Some agreements embedded the choice of law in the "Formation" clause and definitions.

31. The provisions selected Pennsylvania, Illinois, and New York law. A few operating agreements paired Delaware law with another law (Delaware in general and Nevada for particular construction-related claims) or elected two sources of governing law (Delaware and Pennsylvania). This split choice of law is not unprecedented. *See* Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1153 (Del. Ch. 2006) (noting the "unusual factor" that the Delaware LLC had selected Texas law in its choice of law clause).

32. *See generally* Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189 (2011) (examining why Delaware lacks market and pricing power for LLC formations unlike with corporate formations).

**Table 1:** Choice of Law Governing LLC Agreement*

| | |
|---|---|
| **Choosing Delaware Law, total sample, n = 233** | 97% *n = 225* |
| **Choosing Another State's Law, total sample, n = 233** | 2% *n = 4* |
| **No Express Choice of Law, total sample, n = 233** | 2% *n = 4* |

### *B. Choice of Forum: Exclusive Forum and Mandatory Arbitration*

The LLC operating agreement may also designate where a dispute is resolved. The Delaware statute makes the Chancery Court a default location for adjudicating disputes among the LLC's constituents, but the statute does not restrict litigation to the Chancery Court.[33] Delaware's LLC Act anticipates that LLC operating agreements may include terms that alter this default forum. Section 18-109(d) allows the operating agreement to restrict intrafirm litigation to Delaware courts, permit suit outside of Delaware without excluding the Delaware courts, or elect mandatory arbitration inside or outside of Delaware.[34]

#### *1. Exclusive Forum Clauses*

In our sample, 26% of the LLC operating agreements included an exclusive forum provision that restricted judicial resolution of disputes to a particular court or courts. Most (80%) of these exclusive forum provisions restricted intrafirm disputes to Delaware courts. The remaining 20% of the exclusive forum provisions elected various other courts: California state and federal courts in San Joaquin county; Florida state and federal courts in Miami-Dade county; federal courts of the Northern District of Illinois; New York state and federal courts; and New Jersey state and federal courts.

The exclusive forum clauses restrict disputes to a particular court or courts. In contrast, non-exclusive forum clauses ("consent to jurisdiction" or "permissive" clauses) open a particular forum for disputes without making it mandatory. In our sample, 4% of operating agreements elected a particular forum but did not specify that it was exclusive.[35]

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* Percentages do not add to 100 because of rounding.

33. DEL. CODE tit. 6, §§ 18-110(a) (2008), 18-111 (2009), 18-1001 (1998) (using permissive language when making the Chancery Court available to hear intra-LLC disputes); *see also* Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 292–95 (Del. 1999) (holding that these sections of the Delaware LLC Act established the Chancery Court as a default forum for certain actions "in the event the members did not provide another choice of forum or dispute resolution mechanism").

34. DEL. CODE tit. 6, § 18-109(d) (2000). Exclusive forum clauses restricting suits to non-Delaware courts are enforceable against only members who are managers. *Id.*

35. These non-exclusive forum clauses could be used to identify a favored location for dispute resolution, while still leaving open flexibility to choose another location. Some also may have been poorly drafted attempts at creating an exclusive forum provision.

Parties agreed to be subject to (or not to contest) the personal jurisdiction of a particular court in 19% of the total sample. Most of these (17% of the total sample) appeared in agreements that contained a forum selection clause, either exclusive or permissive. These may reflect how the forum clause was drafted.[36] The remaining 2% consented to personal jurisdiction without otherwise contracting about a judicial forum.

36. *See, e.g.*, John G. Powers, *Planning for Forum Selection in Commercial Transactions*, 78 N.Y. ST. B. ASS'N J., 22, 22 (2006) (listing "express consent by the parties to personal jurisdiction in the selected forum" as one of the essential elements of a well-drafted forum selection clause).

**Table 2:** Forum for Judicial Litigation (Non-Arbitration)

| | |
|---|---|
| **Exclusive Forum Provisions, total sample, n = 233** | 26% *n = 61* |
| ...w/ waiver or exculpation, n = 36 | 39% *n = 14* |
| ...w/o waiver and exculpation, n = 197 | 24% *n = 47* |
| Selecting Delaware, n = 61 | 80% *n = 49* |
| Selecting Exclusively Non-Delaware Courts, n = 61* | 20% *n = 12* |
| **Nonexclusive Forum Provisions, total sample, n = 233** | 4% *n = 10* |
| ...w/ waiver or exculpation, n = 36 | 6% *n = 2* |
| ...w/o waiver and exculpation, n = 197 | 4% *n = 8* |
| **Consent to Personal Jurisdiction, total sample, n = 233** | 19% *n = 44* |
| ...w/ forum selection clause, n = 61 | 56% *n = 40* |
| ...w/o forum selection clause, n = 172 | 2% *n = 4* |

* The courts consisted of California state and federal courts in San Joaquin County, Florida state and federal courts in Miami-Dade County; federal courts of the Northern District of Illinois; New York state and federal courts; and New Jersey state and federal courts.

### *2. Mandatory Arbitration*

As noted above, mandatory arbitration provisions are explicitly allowed in LLC operating agreements.[37] Of our sample, 17% included mandatory arbitration clauses that required the arbitration of all disputes arising under the operating agreement. Agreements selected the location of the arbitration in 13% of the sample. Within the clauses that selected location, 32% selected arbitration in Delaware and 25% selected New York or New York City.[38] The others designated cities in California or Pennsylvania, the company's principal place of business, or other locations (including Maui and Anchorage). To get a full picture of the selection of the dispute resolution process, it is also worth noting that 6% of our sample required non-binding mediation before initiating an arbitration or court process.

37. DEL. CODE, tit. 6, § 18-109(d) (2015).

38. Two clauses selecting Delaware were non-exclusive.

**Table 3:** Arbitration Provisions

| | |
|---|---|
| **Mandatory Arbitration*, total sample, n = 233** | 17% *n = 40* |
| ...w/ waiver or exculpation, n = 36 | 3% *n = 1* |
| ...w/o waiver and exculpation, n = 197 | 20% *n = 39* |
| **Location of Arbitration if Mandatory Arbitration** *n = 40* | |
| Mandatory Arbitration in Delaware** | 23% *n = 9* |
| Mandatory Arbitration in New York** | 18% *n = 7* |
| Mandatory Arbitration Exclusively in Another State | 30% *n = 12* |
| Mandatory Arbitration, No Location Specified | 30% *n = 12* |
| **Arbitration Location Specified, total sample, n = 233** | 13% *n = 31* |
| ...w/ waiver or exculpation, n = 36 | 3% *n = 1* |
| ...w/o waiver and exculpation, n = 197 | 15% *n = 30* |

* Agreements were deemed to require arbitration if they specified that all disputes, or all disputes among members, must be arbitrated. Two agreements were excluded that required only enumerated claims to be arbitrated. Agreements that allowed parties to seek injunctions outside the arbitration process were included.

** Mandatory arbitration in Delaware and in New York includes agreements that selected Delaware or New York, respectively, as either the exclusive or nonexclusive location for arbitration.

### *C. Service of Process*

By default, documents initiating litigation must be personally delivered to the person being sued, which can be a cumbersome and expensive procedure. Delaware's LLC law allows parties to make service of process less costly. While providing that managers can be served with process if documents are delivered to the Delaware Secretary of State, the statute also allows parties to tailor terms of the process serving procedure to individual circumstances by specifying terms in the operating agreement.[39] Table 4 shows the prevalence of facilitating the process serving procedure for LLC members. Common provisions deemed process to have been served upon mailing papers through a reliable courier to the member's address of record, or upon serving the Delaware Secretary of State.

**Table 4:** Modifying Process Serving Procedures

| | |
|---|---|
| **Process Serving Modification, total sample, n = 233** | 14% *n = 33* |
| ...w/ waiver or exculpation, n = 36 | 22% *n = 8* |
| ...w/o waiver and exculpation, n = 197 | 13% *n = 25* |

### *D. Books and Records*

Alteration of access to books and records affects more than just the dispute resolution process, as it determines whether and how members access information about the LLC. Nevertheless, we analyze it here because access to books and records can provide information needed to develop a lawsuit or other action. In the absence of discovery early in the process or in a forum where discovery is limited or unavailable, this access becomes a practical necessity.

Delaware law provides a default right of access to a company's books and records to all members of the LLC.[40] Operating agreements are allowed to impose reasonable restrictions on this right.[41] In our sample, 6% of LLC operating agreements included a clause restricting access to books and records by members, typically by preventing access by members with small interests or certain classes of members.

39. DEL. CODE tit. 6, § 18-109(a), (b), (e) (2000).

40. *Id.* § 18-305(a) (2014).

41. Arbor Place, L.P. v. Encore Opportunity Fund, LLC, No. Civ. A. 18928, 2002 WL 205681, at *4 n.9 (Del. Ch. Jan. 29, 2002) (noting that books and records inspection rights can be "broader or narrower than the statutory right by its own terms").

**Table 5:** Limitations on Books and Records Access

| | |
|---|---|
| **Limited Books Access, total sample, n = 233** | 6% *n = 14* |
| ...w/ waiver or exculpation, n = 36 | 8% *n = 3* |
| ...w/o waiver and exculpation, n = 197 | 6% *n = 11* |

### *E. Procedural Rules*

In a regime of free contracting, the parties might alter almost any aspect of the dispute resolution process. This Section reports two categories of clauses that altered particular aspects of dispute resolution: clauses that allocate the costs of legal proceedings (including fee-shifting provisions) and jury waivers. The results are reported below.

#### *1. Fee-Shifting and Other Cost Allocation*

Within the operating agreements in our study, we identified clauses that allocate the costs of dispute resolution among the parties. They do so against the backdrop of the default "American rule" in which each side bears its own costs of legal action. Therefore, if the operating agreement fails to include a fee-shifting provision, parties bear their own costs.

Approximately 20% of the total sample included fee-shifting provisions that applied to litigation, arbitration, or both. Approximately two-thirds of operating agreements that included fee-shifting provisions adopted language that covered all legal proceedings, including both litigation and arbitration. These were often labeled "Attorneys' Fees" clauses, although the costs were generally not limited to attorneys' fees, but included the full panoply of costs arising from legal proceedings. An additional 9% of the agreements that contained some sort of fee-shifting provision limited its scope to expenses in judicial proceedings and not arbitration. All of the broadly worded and litigation-only clauses were "loser-pays" provisions, which allow the "prevailing party" to recover legal costs.[42]

The remaining 23% of the agreements that contained fee-shifting provisions targeted arbitration only.[43] Arbitration costs were allocated in a more varied way than were

42. It is worth noting the contrast between these loser-pays clauses and the fee-shifting provisions that emerged in corporate bylaws. The corporate bylaws were often one-sided and required the plaintiff shareholder to pay any time they did "not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought." ATP Tour Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 556 (Del. 2014) (quoting Article 23 of the Amended and Restated Bylaws of ATP Tour, Inc. (adopted on Oct. 22, 2006)). *See generally* Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 330 (2013) (describing the varied ways to structure fee-shifting provisions).

43. For fee-shifting in the context of arbitration, agreements were counted if the loser had to pay the winner's legal expenses.

litigation costs. Most provisions required fee-shifting of all arbitration expenses, but others shared arbitrators' expenses equally while making the loser pay all the winner's other expenses associated with arbitration.[44]

44. Forty-three agreements in our sample included arbitration fee-shifting under our definition (loser has to pay winner's legal expenses). Thirty-eight of those agreements applied fee-shifting to all arbitration expenses. The remaining five applied it to all expenses except the arbitrators' costs, which were shared equally. Even agreements that did not include arbitration fee-shifting under our definition sometimes allocated costs. Ten agreements made clear that arbitrators' expenses would be borne equally without including an additional cost-shifting provision for other arbitration expenses. In addition, five agreements specified there would be no fee-shifting in the context of arbitration. In contrast, no agreements expressly prohibited fee-shifting for judicial proceedings.

**Table 6:** Fee Shifting

| | |
|---|---|
| **Arbitration Fee Shifting, total sample, n = 233** | 18% *n = 43* |
| ...w/ waiver or exculpation, n = 36 | 11% *n = 4* |
| ...w/o waiver and exculpation, n = 197 | 20% *n = 39* |
| ...arbitration required, n = 40 | 43% *n = 17* |
| ...arbitration not required, n = 193 | 13% *n = 26* |
| **Judicial Fee Shifting, total sample, n = 233** | 15% *n = 36* |
| ...w/ waiver or exculpation, n = 35 | 14% *n = 5* |
| ...w/o waiver and exculpation, n = 156 | 16% *n = 31* |
| ...arbitration required, n = 40 | 15% *n = 6* |
| ...arbitration not required, n = 193 | 16% *n = 30* |
| **Judicial and/or Arbitration Fee Shifting, total sample, n =233** | 20% *n = 47* |
| **Scope of Fee-Shifting Clauses (if fee-shifting present)** *n = 47* | |
| Judicial and Arbitration Fee Shifting | 68% *n = 32* |
| Only Judicial Fee Shifting | 9% *n = 4* |
| Only Arbitration Fee Shifting | 23% *n = 11* |

*2. Jury Waivers*

Of the total sample, 15% of the agreements included a clause that waived trial by jury. Because mandatory arbitration also effectively eliminates access to a jury, one way of evaluating the overall effect of these contracts on jury access is to cumulate two categories: first, agreements that preserve court actions by not imposing mandatory arbitration but that contain jury waivers; and second, those agreements subject to mandatory arbitration. Taking this approach, 30% of all of the agreements in the sample effectively waived a jury trial, either through an explicit jury waiver clause, through a mandatory arbitration clause, or by including both clauses. Agreements were just as likely to waive the jury trial right in judicial proceedings even when they included a mandatory arbitration clause, despite the apparent lack of value that jury trial waiver has in the arbitration context.

**Table 7:** Jury Waiver

| | |
|---|---|
| **Jury Waiver, total sample, n = 233** | 15% *n = 36* |
| ...w/ waiver or exculpation, n = 36 | 22% *n = 8* |
| ...w/o waiver and exculpation, n = 197 | 14% *n = 28* |
| ...arbitration required, n = 40 | 15% *n = 6* |
| ...arbitration not required, n = 193 | 16% *n = 30* |
| **Jury Waiver and/or Mandatory Arbitration, total sample, n = 233** | 30% *n = 70* |

### *F. Summary*

The above analysis shows that LLCs engage in widespread modification to dispute resolution procedures. Table 8 summarizes the main results.

**Table 8:** Summary of Dispute Resolution Modifications

| Modification, total sample | Prevalence |
|---|---|
| Arbitration Required | 17% |
| Arbitration Forum | 13% |
| Books/Records Access Limited | 6% |
| Exclusive Forum, Judicial Disputes | 26% |
| Nonexcl. Forum, Judicial Disputes | 4% |
| Arbitration Fee Shifting | 18% |
| Judicial Fee Shifting | 15% |
| Jury Waiver | 15% |
| Process Serving Modification | 14% |

### *G. Relationship to Exculpation and Waiver*

Because of the commitment to freedom of contract, the LLC form allows broad tailoring of LLC agreements. In many jurisdictions, including Delaware, this includes the ability to waive fiduciary duties or exculpate managers or members.[45] This ability to curtail substantive claims potentially interacts with the desirability of dispute resolution provisions. Determining ahead of time in the operating agreement where and how a future dispute is resolved may seem less pressing if the underlying claims that can be brought are

45. Molk, *supra* note 2, at 11–12 (noting that Delaware law preserves the duty of good faith, but otherwise permits broad tailoring of provisions "allowing for complete elimination of fiduciary duties, exit rights, and voting rights, for example").

restricted or eliminated. The table below reflects this intuition, charting the categories of dispute resolution provisions within two populations: those LLCs that waive or exculpate the fiduciary duties of both care and loyalty, and those LLCs that do not.

**Table 9:** Provision Comparison, LLCs w/ and w/o Exculpation/Waiver (E/W)

| Modification | |
|---|---|
| Exclusive Forum, Judicial Disputes | LLCs w/ E/W Significantly Higher* |
| Nonexcl. Forum, Judicial Disputes | No statistical difference |
| Personal Jurisdiction Consent | No statistical difference |
| Arbitration Required | LLCs w/ E/W Significantly Lower*** |
| Arbitration Forum | LLCs w/ E/W Significantly Lower*** |
| Process Serving Modification | No statistical difference |
| Books/Records Access Limitation | No statistical difference |
| Arbitration Fee Shifting | No statistical difference |
| Judicial Fee Shifting | No statistical difference |
| Jury Waiver | No statistical difference |

We can see that, as intuition might suggest, those LLCs that effectively eliminate liability for duty of care and loyalty violations have significantly lower rates of mandatory arbitration than those LLCs that maintain liability for one or both of these fiduciary duties. However, other dispute resolution terms did not differ meaningfully based on whether the LLC waived or exculpated fiduciary duty breaches. If we assume that limiting the claims

* Significant at 10%.
*** Significant at 5%.
*** Significant at 1%.

that dissident members can bring makes tailoring other litigation procedures less beneficial and therefore less important, it is surprising to find such commonality among companies with and without fiduciary duty waivers or exculpations. On the other hand, if parties care about disputes beyond fiduciary duty claims, or if LLC terms are not always the product of individualized negotiation,[46] statistically insignificant variations across a variety of terms may not be surprising.

## V. IMPLICATIONS

Contrary to the focus of popular attention, publicly traded corporations are not the only entities subject to active tailoring of the dispute resolution process beyond the traditional default provisions that have reigned for years. All business organizations face the same basic problem of allocating appropriate rights for investors while preserving management's ability to do its job. It is therefore not surprising that, as the prior Part demonstrated, LLCs regularly take steps to alter the litigation landscape, just as corporations have begun to do.

What is surprising, however, is that entities beyond corporations have not attracted the same attention from the legal community. Arguments for curtailing fee shifting in the context of corporations, for example, would also push for a critical assessment of its propriety when employed by non-corporate organizations. Of course there may be differences among organizations that might make limitations on litigation rights more or less alarming. The concern with shareholder consent, for example, which motivates many critiques of corporate litigation bylaws, may be less troubling in a closely held LLC, where those bound are generally signatories. Also, privately held LLCs on average will be smaller than publicly traded corporations and may suffer less often or less severely from the rational indifference of investors in publicly traded corporations. But to say the costs might be lower in the context of LLCs is not to say they are nonexistent. Many LLCs are large and widely held, for example, which mirrors the situation driving concerns with publicly traded corporations. In light of our findings that the procedures are being altered regularly, a critical assessment of dispute resolution provisions should do much to advance this discussion, particularly if calls for new mandatory LLC member protections gain traction and place potentially greater strain on the dispute resolution process.[47]

In addition to showing a need to assess the wisdom of internal modifications to dispute resolution in the context of LLCs, our study of LLC operating agreements also provides a valuable lens through which we might gain insight into the future of corporate litigation limitations. Delaware LLCs represent the outer bound of contractual permissibility. Practically any investor protection can be varied by placing terms in the operating agreement. The fact that so many LLCs vary default terms of the dispute resolution process when given the freedom to do so may suggest a pent-up demand for similar actions by corporations that are constrained by various mandatory rules or guided by prior practice.

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46. For an argument along these lines, see generally Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295 (2014) (discussing how LLC terms are not necessarily "always negotiated").

47. *See, e.g.*, Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* HANDBOOK ON ALTERNATIVE ENTITIES (Mark Lowenstein & Robert Hillman eds., 2015) (proposing a mandatory duty of loyalty for publicly traded LLCs).

## VI. CONCLUSION

Although the use of corporate governance documents to vary the dispute resolution process has attracted public attention, practices outside the corporate context remain underexplored. We show that LLCs engage in a remarkable level of contractual variation in tailoring the procedures that govern disputes, raising questions about the balance of power between managers and investors similar to those that gave rise to legislative action in the context of corporations. While it is far too early to tell whether this practice on balance promotes LLC economic efficiency or instead exacerbates the costs of doing business, our findings show a continued need to consider how the same factors that drive controversial outcomes in corporations can give rise to the same behavior in the far more common non-corporate business entities.

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