Westlaw Journal
CORPORATE OFFICERS & DIRECTORS LIABILITY
Litigation News and Analysis • Legislation • Regulation • Expert Commentary
VOLUME 29, ISSUE 11 / DECEMBER 2, 2013

EXPERT ANALYSIS

3rd Circuit Rules Delaware Chancery Court Arbitrations Must Be Open to the Public

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The resolution of business disputes through arbitration proceedings conducted by the Delaware Chancery Court must be public, according to a recent federal appeals court ruling.

The 3rd U.S. Circuit Court of Appeals ruled in *Delaware Coalition for Open Government v. Strine*[1] that the state's business dispute arbitration program, conducted by Chancery Court judges, consists of essentially civil trials and, therefore, must be open to the public, under the First Amendment. The Delaware Bar and various business groups argued that the confidentiality of Chancery Court arbitration proceedings is essential to the success of the program. Most corporate lawyers recognize, however, that Delaware's little-known Section 349[2] arbitration program, even without blanket confidentiality, remains a very attractive option for the resolution of many business disputes.

Corporate lawyers routinely provide in contracts that Delaware courts will be the exclusive jurisdiction and venue for dispute resolution. Delaware courts enjoy an excellent reputation for responsiveness to corporate concerns, judicial expertise in business and corporate law matters, and a docket which produces relatively expeditious decisions. The principal drawback of choosing Delaware courts, however, is the lawsuit is too expensive and formal. The lack of privacy in a civil trial is also a legitimate concern, but the public and the press have no interest in most business disputes. Moreover, the Chancery Court rules provide ample measures for protecting legitimate trade secrets from public disclosure.

LITIGATE OR ARBITRATE?

Arbitration is also a popular method for resolving business disputes. The primary disadvantage of arbitration in the minds of many lawyers is the uncertainty regarding the arbitrator who will handle the dispute. Groups such as JAMS Inc. and the American Arbitration Association screen the arbitrators. Legitimate concerns can arise about private arbitrators' substantive knowledge, judicial temperament and experience, though. In contrast, Chancery Court judges are the gold standard when it comes to knowledge of the law, institutional respect, judicial demeanor and a reputation for ruling expeditiously. The non-jury Delaware Chancery Court, founded in 1792, is recognized as providing fast-track trials on complex business disputes by very knowledgeable and practical judges.

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The new Section 349 Chancery Court arbitration, adopted by the Delaware Legislature in 2009, provides an ideal, hybrid business dispute resolution process. To be eligible for the Chancery Court arbitration, the parties must consent, at least one party must be a Delaware business entity, neither party can be a "consumer" and the amount in controversy must be at least $1 million.

The parties start the arbitration by filing a petition with the Chancery Court and paying a $12,000 filing fee. The fee increases $6,000 per day after the first day in the courtroom. After receiving a petition, the chancellor selects a Chancery Court judge to hear the arbitration. The arbitration begins about 90 days after the petition is filed and is conducted in the Delaware courthouse during normal business hours. Regular Court of Chancery Rules 26-37, governing depositions and discovery, apply to the proceedings, but the rules can be modified by consensual agreement of the parties.

The Chancery Court judge presiding over the arbitration "may grant any remedy or relief that he deems just and equitable within the scope of any applicable agreement of the parties."[3]

ARBITRATION APPEAL OPTION UNAPPEALING

Once a decision is reached, the final judgment or decree is automatically entered. Both parties have a right of appeal to the Delaware Supreme Court, but review of the arbitration award is very deferential and will generally only be set aside upon fraud, judicial misconduct or material mathematical error.

The aspect of Delaware's Section 349 arbitration process causing the controversy was the provision barring public access to the proceedings. Arbitration petitions are confidential and not included as part of the public docketing system. The public cannot determine the parties or the nature of the matter. Attendance at the arbitration is limited to the parties, and all pleadings and material communications are protected from disclosure.

The Delaware Coalition for Open Government challenged the provisions related to confidentiality under the First Amendment in federal court. U.S. District Judge Mary McLaughlin granted judgment on the pleadings. She ruled that the arbitration proceedings, conducted under Delaware law and Chancery Court rules, where a sitting judge hears evidence, finds facts and issues an order dictating the obligations of the parties, are essentially non-jury trials. Therefore, the First Amendment protects a qualified right of access, and the business arbitration proceeding must be open to the public.[4]

Business groups, including the U.S. Chamber of Commerce and the New York Stock Exchange, urged the 3rd Circuit to maintain the closed arbitration process, saying companies should be allowed to resolve disputes in private if all sides agree.

A GREATER GOOD

The argument of the business interests makes sense, but for the long-standing tradition of public access to court proceedings under the U.S. Constitution. Presumably, the parties in most litigation would prefer to close the proceeding to the public. There is a greater, countervailing public good, however, from public access to trials. Ironically, the predictability of Delaware corporate law and the prestige of the Chancery Court derives, in substantial part, from public access to Delaware court opinions.

The First Amendment prohibits governments from "abridging the freedom of speech, or of the press," which the U.S. Supreme Court in *Richmond Newspapers v. Virginia* interpreted to include a right to public access to trials.[5] The First Amendment is made applicable to the states by the 14th Amendment.

In *Richmond Newspapers* the Supreme Court held that closing a criminal trial to the public violated the First Amendment. The court emphasized the important role public access plays in the administration of justice. The court concluded that the "explicit, guaranteed rights to speak and publish concerning what takes place at a trial would lose much meaning if access to observe the trial could ... be foreclosed arbitrarily."[6]

A proceeding qualifies for First Amendment right of public access when "there has been a tradition of accessibility" for that kind of proceeding, and when "access plays a significant positive role in the functioning of the particular process in question."[7] The court applies an analysis known as the "experience and logic" test; in order to qualify for public access, both experience and logic must counsel in favor of opening the proceeding to the public. Once a presumption of public access is established, it may only be overridden by a compelling government interest.[8]

THE EXPERIENCE PRONG

The 3rd Circuit held that, under the experience prong of the test, the court must "consider whether the place and process have historically been open to the press and general public because such a tradition of accessibility implies the favorable judgment of experience."[9]

"[U]ncritical acceptance of state definitions of proceedings would allow governments to prevent the public from accessing a proceeding simply by renaming it. A First Amendment right that mandated access to civil trials, but allowed closure of identical 'sivel trials' would be meaningless," Circuit Judge Dolores Sloviter wrote.[10]

The appeals court's opinion placed the Delaware Chancery Court arbitration process within a historical perspective. The 3rd Circuit recognized a long history of access to civil trials.

The English history of access dates back to the Statute of Marlborough passed in 1267, which required "all causes ... to be heard, ordered and determined before the judges of the King's Courts [were to be heard] openly in the King's Courts."[11] According to the 3rd Circuit, "[t]his tradition of openness continued in English courts for centuries, insuring that evidence was delivered 'in the open court in the presence of the parties, their attorneys, counsel and all by-standards, and before the judge and jury.'"[12] According to Judge Sloviter, "one of the most conspicuous features of English justice, that all judicial trials are held in open court, to which the public have free access ... appears to have been the rule in England from time immemorial."[13]

"This tradition of access to trials and the courthouse was adopted by the American colonies and preserved after the American revolution."[14] The 3rd Circuit said, "The courthouse, courtroom and trial remain essential to the way the public conceives of and interacts with the judicial system."[15]

"Although Delaware's government-sponsored arbitrations share characteristics such as informality, flexibility and limited review with private arbitrations, they differ fundamentally from other arbitrations because they are conducted before active judges in a courthouse, because they result in a binding order of the Chancery Court, and because they allow only a limited right of appeal."[16]

In applying the logic prong of the test, the 3rd Circuit addressed whether "access plays a significant positive role in the functioning of the particular process in question."[17] The appeals court said:

> We have recognized that public access to judicial proceedings provides many benefits, including [1] promotion of informed discussion of governmental affairs by providing the public with the more complete understanding of the [proceeding]; [2] promotion of the public perception of fairness which can be achieved only by permitting full public view of the proceedings; [3] providing a significant community therapeutic value as an outlet for community concern, hostility and emotion; [4]

The Chancery Court judge presiding over the arbitration "may grant any remedy or relief that he deems just and equitable within the scope of any applicable agreement of the parties."

> serving as a check on corrupt practices by exposing the [proceeding] to public scrutiny; [5] enhancement of the performance of all involved; and [6] discouragement of [fraud].[18]

The 3rd Circuit said all these benefits would be seen from opening Delaware's proceedings. Stockholders and the public would have a better understanding of how Delaware deals with business disputes during arbitration. Public access would also open the litigants, lawyers and judge to some criticism from the press and public, and it would prevent companies from making misrepresentations.[19]

THE SURPRISING DISSENT

Perhaps the most surprising aspect of the case is Circuit Judge Jane Roth's dissent. It is easy to understand Judge Roth's sympathy for a private arbitration process conducted by the Chancery Court for well-heeled, consenting businesses. Delaware's legislature panders to its business entities, which provide 24 percent of the state's general fund revenue. This is a civil dispute resolution process, however, established by state statute and state court rules, and where the decision is entitled to the dignity of a state court judgment and appeal to the state Supreme Court. Therefore, it must fall under the category of civil litigation and be subject to the First Amendment.[20]

Attendance at the arbitration is limited to the parties, and all pleadings and material communications are protected from disclosure.

Judge Roth stressed the need for confidentiality in resolution of conflicts involving sensitive data to prevent access by competitors. The Delaware court rules provide the tools for the court to protect legitimate confidential information from disclosure, though. The Delaware business arbitration statute, which extends confidentiality to the names of the parties and the general nature of the dispute, goes far beyond protecting "confidential" data.

Judge Roth, in her dissent, also said, "businesses in this country and abroad need to get commercial conflicts resolved as quickly as possible so that commercial relations are not disrupted."[21] Arbitration, with the rules set by the parties, allows businesses to do that, she said.[22] "The point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute."[23] The 3rd Circuit's decision to provide public access consistent with the First Amendment does not interfere with any of these lofty objectives, though.

In the final analysis, Section 349 arbitration proceedings before the Chancery Court continue to provide an excellent dispute resolution option for lawyers drafting contracts. The loss of confidentiality is regrettable from the perspective of the contract parties. Still, the attractiveness of having the dispute handled by a judge of the Chancery Court, arguably the most respected and capable trial court in the world for business disputes, probably outweighs a confidential proceeding by an unknown and unproven arbitrator. In those cases where confidentiality is a paramount concern, private arbitration in another forum remains an option.

NOTES

1 *Del. Coal. for Open Gov't v. Strine*, 2013 WL 5737309 (3d Cir. Oct. 23, 2013).

2 *See* 10 Del. Code. Ann. tit. 10, § 349 (2009); Del. Ch. R. 96-98.

3 Del. Ch. R. 98(f)(1).

4 *Del. Coal. for Open Gov't v. Strine*, 894 F. Supp. 2d 493 (D. Del. 2012).

5 *Richmond Newspapers Inc. v. Virginia*, 448 U.S. 555 (1980).

6 *Id.* at 576-77.

7 *Press-Enter. Co. v. Super. Ct.*, 478 U.S. 1, 10 (1986).

8 *Id.*

9 *Del. Coal.*, 2013 WL 5737309 at *4, quoting *N.J. Media Group v. Ashcroft*, 308 F.3d 198, 213 (3d Cir. 2002).

[10] *Del. Coal.*, 2013 WL 5737309 at *4.

[11] *Id.* at *5, citing *Publicker Indus. v. Cohen*, 733 F.2d 1059, 1068 (citing 2 EDWARD COKE, INSTITUTES OF THE LAW OF ENGLAND 103 (6th ed. 1681)).

[12] *Del. Coal.*, 2013 WL 5737309 at *5.

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.* at *7.

[17] *Id.* at *8, *quoting Press-Enter,* 478 U.S. at 8.

[18] *Del. Coal.*, 2013 WL 5737309 at *8.

[19] *Id.*

[20] Del. Div. of Revenue 2011 Annual Report, available at http://www.corp.Delaware.gov/2011Corpar.pdf.

[21] *Del. Coal.*, 2013 WL 5737309 at *13.

[22] *Id.*

[23] *Id.*

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