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Delaware Private Arbitration: An Explanation of Delaware's Chancery Arbitration Program and Its Benefits

*Gregory Varallo
John Mark Zeberkiewicz*

SAM FAYE: Moving on, it is my pleasure to present Mr. Greg Varallo and Mr. John Mark Zeberkiewicz. Both of them are here from Wilmington, Delaware where the majority of their practices revolve around a variety of corporate matters.

Both of these gentlemen are familiar with the private arbitration program that the State of Delaware recently passed but declared unconstitutional. But they're here to present their opinion of the program, their involvement in it, and the possible outcomes and effects that may come.

GREGORY VARALLO: Thanks, Sam. Thank you very much for the kind welcome. Before I start, let me just say that John Mark and I do a fair amount of speaking around the country, and it's been our experience that these things are best when they're interactive. So let's consider ourselves to be in a seminar or a classroom, and to the extent anybody has questions, comments, or just wants us to stop and dilate on a subject, please, just speak up. Merely because we're sitting at a different table doesn't mean that you shouldn't have the opportunity to jump in. We will be jumping, stepping on each other as we try to make it as interactive as possible.

My name is Greg Varallo. I'm with Richards, Layton & Finger in Wilmington, Delaware, where I've practiced for about thirty years, primarily in corporate governance and related litigation.

Sam's invitation to us to speak came at an unusual time. Our firm, and John Mark and I in particular, has been enmeshed in most of the private arbitrations in Delaware. But as he mentioned, that regime had been enjoined, and it had been enjoined relatively recently prior to Sam's invitation.

So when we were invited, our first reaction was sure, we'd love to speak about the program, but Sam, did you know that the program was enjoined and we might not be au courant by the time we get to your seminar? We were assured that he really wanted to hear about

our experiences and about the program broadly, so we agreed to come.

And basically what we're going to do today is speak a little to the historical background, that is, how we got here. But I want to start by putting this in context—Why does it matter what Delaware's doing? How does it fit within the broad sort of ADR developments nationally and internationally? And then perhaps where might we be going in the future.

As we walk through that, I want to start by talking about Delaware broadly and how ADR fits. Secondly, our initial foray into court-annexed mediation, and then turn to this arbitration program, and finally lessons learned from the first year in arbitration.

So with that as background on where we will be going, we'll be dividing this up and going back and forth as we go. And again, please jump in if you have questions. So how does this fit? What's the context, why Delaware, why is it important, and what's the background? If I were you, I'd be asking those questions.

I think in many ways, Delaware's private arbitration program is one small entrepreneurial state's next step in attempting to secure its position at the forefront of complex business dispute resolution. Our business law model broadly conceived really drives about a quarter of the state's annual revenue. So it's of extraordinary importance to us.

It's, in fact, substantially more important than many of the state taxes that are levied on our physical citizens rather than our juridical citizens, and that system is built on more than a century's extraordinary cooperation between bench, bar, and legislature.

The Delaware General Corporation Law was first adopted in 1899. We copied it wholesale from New Jersey, as Nevada copied it wholesale from us in the 1970s. But we have a system which is based not only on the 1899 corporation law, but a corporation law which is alive and which grows and accommodates clients' needs every single year.

There's a process where experts at the bar propose new changes to the General Corporation Law every year. Those changes are sent down to the General Assembly, our legislature, and there is a broad unwritten understanding that the General Assembly will hold hearings and then adopt those changes verbatim without adding or subtracting a thing.

It's worked for over 100 years; it works extremely well, and it is ongoing today. John Mark, do you want to talk for a few minutes about how that system works?

JOHN MARK ZEBERKIEWICZ: Essentially the process works as follows: The Council of the Corporation Law Section of the Delaware State Bar Association, which is composed primarily of experienced attorneys from law firms throughout the state who appear on both sides of the *v.*, receives on a fairly regular basis, whether from its own members or from other attorneys within the firms represented on the Council, suggestions for proposed amendments to the General Corporation Law of the State of Delaware.

The Council meets on a regular basis and considers these proposed amendments. In some cases, the proposed amendments are minor “clarifying” or “confirming” amendments that are intended to dispense with a potential ambiguity. In other cases, the proposed amendments are significant and would represent major shifts in the law. In the latter cases, the Council will often form a subcommittee to study the issue, make recommendations whether to proceed with the proposed amendments and, if so, draft the proposed legislation. In many cases, the subcommittees, when formed, meet frequently over a period of several months (and sometimes years), turning numerous drafts of proposed legislation. Once the subcommittee has completed its work, it will present the final proposed legislation to the full Council, members of which may then have additional questions or comments requiring further review and drafting. I have had the opportunity to participate in two subcommittee processes, and I can say, from my experience, that a substantial amount of time and effort goes into the preparation of proposed legislation.

By the time a proposed piece of legislation has been finally approved by the Council, it is in the form of a bill that is ready to be submitted to the Delaware General Assembly. The bill is then sponsored by one or more legislators. The sponsor or sponsors will shepherd the bill through the appropriate committees, following which it is submitted to a vote in Delaware’s Senate and House of Representatives. In the span of my career, I have not seen much debate on the bills in the General Assembly. In fact, I am aware of only one instance in which there was significant debate. That was when section 203, which is Delaware’s antitakeover statute, was adopted back in 1988.¹ Leading up to the adoption of section 203, there was substantial debate over the scope and application of the section, particularly whether corporations were going to be required to opt-in or opt-out of it.

1. DEL. CODE ANN. tit. 8, § 203 (West 2013).

Many of the transcripts of the hearings, as well as the letters from various constituencies lobbying their particular views on the statute, are available and provide an interesting window into the adoption of that particular amendment. Other than that, though, there is really not much debate over the bills in any year and, as a result, there is scant legislative history for amendments to the General Corporation Law.

I will tell you in my career, I've never seen much debate at all at the legislature. I'm only aware of one situation where there was a huge debate, and that was back when section 203, which is Delaware's antitakeover statute, when that was adopted back in the mid-1980s, there was substantial debate and all of the transcripts of the hearings and the letters that went back and forth are available.

By way of example, I went down to the General Assembly in 2010 to present the proposed amendments to the General Corporation Law that year and to address questions regarding the amendments. The package of amendments included various changes to section 145 of the General Corporation Law,² which is a fundamental section of the statute dealing with indemnification and advancement of expenses for a corporation's directors, officers, employees, and agents. The package also included a new section of the General Corporation Law, section 267,³ which would enable limited liability companies to effect a short-form merger with a 90%-owned corporation. Finally, the package included substantial amendments to Delaware's nonstock corporation law.

There are thousands upon thousands of Delaware stock corporations, including 60% of the Fortune 500. There are 20,000 to 30,000 nonstock corporations. Of the questions I received that day, though, the lion's share, to my recollection, related to the nonstock corporation amendments. Many of those questions related to how the changes to the nonstock corporation law would affect homeowners' associations or other nonprofit organizations that would directly affect the legislator's constituents. On the broad-based stock corporation law amendments, though, the legislators deferred to the judgment of the Council and the members of the Delaware State Bar Association. I think there is a certain level of trust between the legislators and members of the Delaware Bar. Both camps know how critically important it is for Delaware's corporation law to be modern, clear, and responsive to the needs of corporations and their investors.

2. *Id.* § 145.

3. *Id.* § 267.

GREGORY VARALLO: So we've got an up-to-date statute, but, of course, that doesn't work very well unless you have good judges interpreting the statute. And we've dealt with that in a couple of ways. We've got a bench in our Court of Chancery made up of five business law expert judges.

Those judges, year in and year out for the last ten years, have been recognized by the United States Chamber of Commerce as the leading court in the country. And it's an equity court, and it's the only one of the fifty states—Delaware's the only one of the fifty states that never merged law and equity. So it's an equity court that traces its jurisdiction directly to the High Court of Chancery in London, and theoretically, you're supposed to be able to cite English cases to it if you can't find one from Delaware.

The five chancellors are renowned business law experts, and importantly, we appoint our judges in a merit selection process rather than by election. And those judges serve for twelve-year terms subject to reappointment by the governor. In addition, our constitution requires a balance between the major parties on the courts. So politics are effectively removed from the process. You never have more democrats than republicans and vice versa.

As equity jurists, they work without juries. Punitive damages are not available in equity, so you're not seeing large punitive awards. And their decisions are directly appealable to one layer of appellate court, the Delaware Supreme Court. That court has five members, three of which are former members of the Court of Chancery and are also very well-esteemed.

So under the leadership of our last chancellor, the administrative head of the court and a judge as well, but under the leadership of Bill Chandler, our last chancellor, the court—realizing that it had done probably pretty much everything it could do to keep its rules and its processes and its customs up-to-date and usable for the bar for not only the state but around the country as well—began to look at ADR as an additional offering that the state might make available to its constituents.

In its first foray, which continues to operate today, the court offered a private judicial mediation program. That is to say, by consent, any two parties, as long as there's some nexus to Delaware—one's either a Delaware citizen because it's a natural person, or alternatively, a Delaware corporation—can determine to have one of the five sitting members of the court act as mediator.

Now, importantly, there are mediation programs throughout the court system in the U.S., but typically those mediation programs in-

volve pending cases in the court. This particular system allows you to take a pending court case into mediation before a different member of the court, or alternatively, by agreement, to simply file a mediation-only case.

There are a number of benefits to this particular mediation program. One is that you're dealing with one of the five esteemed members of the Court of Chancery. Second, it's entirely private. The mediation-only docket, for example, is not available on LexisNexis, and it is simply not something that you can find out about no matter how hard you push.

And third, having done a large number of these mediations before the court, there is some inherent value and perhaps a substantial inherent value in bringing a client into the court system and allowing that client to hear an evaluation of its case from a sitting judge, a judge who is, for this purpose, acting as mediator but nonetheless a sitting judge.

Clients just tend to listen to jurists a little bit more closely, especially when the jurist is sitting in the same court that its case will proceed in, if there is a case, than other mediators. So those are the pluses.

We've had some minuses along the way, however. Nothing's perfect. The skill set that makes a jurist an outstanding jurist may or may not be a perfect overlap with the skill set that makes a neutral a really good mediator. And like any group of professionals, we have some who are better than others at mediation. I think the pluses outweigh the minuses. There are mediators for sure who are better than our sitting members in the Court of Chancery, in part because they do it every single day.

If you look at some of the leading mediators either in this city or, more broadly, nationally, those men and women make a living doing nothing but ADR. They study it deeply. They're really, really good at it. Sitting jurists who also decide cases also can be very good at it, but don't do it as a steady diet every single day. So there's going to be some disparity in skill set between full-time mediators and those who aren't.

Nonetheless, at least in my experience in dealing with a number of mediations before the court, the value of having the sitting judge acting in an evaluative function is quite high.

But I think Delaware recognized, as we went through our experience with this mediation program, which is ongoing and extremely successful, that that wasn't perhaps the be-all, end-all; that perhaps there were other alternatives that could also be offered to litigants or

prospective litigants. And so in 2009, the legislature passed a statute permitting judicially-run private arbitration.

That is to say, just like with JAMS, the ICC, or any other arbitral body, you could by contract determine and elect to bring a dispute to the Court of Chancery filed on an arbitration-only separate, private docket.

As designed, there were a number of—there are a number of really neat features about this. First of all, once again, it's a sitting judge. So just as sitting judges sometimes don't make the best mediators, I would also suggest to you that lawyers who are trained in arbitration and mediation, while there are many very, very fine ones, sometimes don't make the best sitting judges either.

And this is a program which I think leverages the particular strengths of the Court of Chancery, that is to say, making decisions. Chancery is world-renowned because it's pragmatic, it's practical. It gets to the bottom of things quickly, and it doesn't typically let cases sit very long.

Well, our arbitration regime is sort of chancery supercharged. And the key to it is a rule of the court adopted in early 2010 that says from the first conference, from the time arbitration is commenced through to decision, it should in most cases take no more than ninety days.⁴ So you're dealing with super-fast track arbitration.

One of the earlier speakers talked about many mediated cases getting to final resolution in two years, and that's a perfectly good estimate for the typical complex case. These cases are getting decided or were getting decided before they were enjoined in ninety to one hundred twenty days.

We've had six of them. The rules were adopted on January 5, 2010, and between that point and the injunction, which was in 2011, Delaware processed six of these cases from start to finish. My firm was counsel in five of them, and I was lucky enough to be counsel in four of the six.

JOHN MARK ZEBERKIEWICZ: I will just interject that we were at the very first arbitration hearing—I believe it was the second filed, but it was certainly the first hearing and five minutes or so before the proceeding was underway, each member of the Delaware Court of Chancery had been served with a complaint by the Delaware Coalition for Open Government. The chancellor, who was presiding over our arbitration, let us know.

4. DEL. CH. CT. R. 97(e).

GREGORY VARALLO: And he wasn't very happy that day, if I recall.

JOHN MARK ZEBERKIEWICZ: That was my recollection as well.

GREGORY VARALLO: Actually, I happened to participate with the chancellor in a symposium on Monday in New York City, and he's still not very happy about that development. In any event, so sort of the key to this ninety-day fast track, with a sitting judge as your decider, is that it's extremely customizable. There are a series of rules that say if you don't customize, Rules 26–37 of the Delaware Chancery Court will apply to discovery.⁵ Rules 26–37 look a lot like the Federal Rules of Civil Procedure (FRCP).⁶ So if you think about 26–37 of FRCP, you've got effectively how it looks. But the rules provide that the parties, by agreement, can change any rule and adopt any procedure they want.

Appeal, which would lie directly to the Delaware Supreme Court under the Federal Arbitration Act (FAA)⁷ and is limited, can be waived altogether by contract by the parties. There's a separate—as I mentioned, a separate arbitration-only private docket. And this is for commercial matters where the damage—potential damages are \$1 million or more, where there's a written agreement of the parties and where one of the parties is a Delaware citizen, which includes obviously Delaware incorporated entities.

To the extent that the parties are looking for purely equitable relief, that is to say, an injunction or specific performance and not damages, those cases don't have to be—they don't have to meet the \$1 million jurisdictional threshold. And in the event that you're looking for a mixture of equity and ancillary damages, those cases also don't have to meet the \$1 million jurisdictional threshold.

So it's easy to get in. It requires a written agreement by the parties, and importantly, the way the judges have gone about making this system happen has really been to give the parties the maximum flexibility possible to design how they want the program to look.

If the parties want it to look like an alternative trial with discovery and depositions and interrogatories and requests for admission, it looks like one. If the parties want it to look like a pure argument on an issue of law, it looks like one. Whatever the parties want, the

5. DEL. CH. CT. R. 26–37.

6. See FED. R. CIV. P. 26–37.

7. United States Arbitration Act (known as the Federal Arbitration Act), Pub. L. No. 68-401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1–16 (2006)).

courts have been very good about being responsive to allowing us to craft these too.

I would say as well that as you sort of think about this as an alternative, and hopefully it will soon be an alternative again. The next panel, we're going to talk about the constitutionality issues. The Third Circuit has the appeal, and it's been fully briefed and scheduled for argument, and we ought to know relatively soon, at least at the circuit court level, what the answer is. As you think about how this looks, I can't stress enough that while there are default rules that are available, those rules are subject to being customized in any way, shape, or form.

JOHN MARK ZEBERKIEWICZ: To that point, we have included in the materials for this presentation a form arbitration provision.⁸ As you can see, our form is heavily annotated and goes through in significant detail all of the elements that can be customized.

There are fifteen or so different footnotes, all of which are very extensive. Viewing this carefully, it becomes clear that parties can make the arbitration process operate however they want it to operate, subject to the baseline default rules that Greg had mentioned. Prior to the injunction, there were only six arbitration proceedings. In one of the ones that Greg and I were involved in, the parties did not have an arbitration agreement in place from the outset.

This particular proceeding involved a dispute that had arisen with respect to a provision of the certificate of incorporation—it was, in large part, a dispute over the interpretation of a specific clause. Rather than proceeding to customary litigation, the parties decided it was in everyone's interest to submit the matter to arbitration.

The parties agreed that they would focus only on the narrow issue of contract interpretation. They agreed there would be no discovery. Everyone recognized that there was no need for scorched-earth litigation. Rather, it was in everyone's interest to make sure that the dispute remained focused on the single issue at hand. We were able to do that and do that very effectively.

GREGORY VARALLO: I also want to say I think the other sort of piece of this that's not in the rules and not written down anywhere, unless it's written down in our articles on the subject, has been the ability to pick your arbitrator. The rules contemplate that you'll file a petition. The petition will go to the head of the court or the chancel-

8. *Form of Arbitration Provision*, AM. BAR ASS'N (Aug. 16, 2012), http://www.americanbar.org/content/dam/aba/publications/litigation_committees/commercial/summer2012_annex_a.authcheckdam.pdf.

lor. The chancellor will assign an arbitrator among one of the five sitting members of the court.

But what grew up under the mediation ADR regime and was sort of carried over informally to the arbitration side is that if the parties decide we want vice chancellor so-and-so as opposed to any of the others and you send a letter to the chancellor with your petition and say, "Please appoint vice chancellor so-and-so. We've agreed among ourselves to arbitrate before that member of the court," then you get that member of the court. At least based upon our initial experience, you get that member of the court. Same thing on the arbitration side, and it's a carryover, I think, of the intention to make this as user-friendly and productive as possible.

So let us switch, if we can, for a couple of minutes to talking about a number of our experiences. Obviously, these are mostly private, so we won't use names of clients, but we'll talk about the kinds of disputes we've seen processed through this regime. And then maybe turn to our form and talk you through some of the issues you should think about that have come out of this regime and our experiences in the regime. And hopefully those experiences will be useful to you whether you're in chancery, JAMS, AAA, or any other regime.

There are just a number of things to think about in crafting what our luncheon speaker rightly described as being the all-important arbitration agreement. So experiences, starting with the one John Mark talked about, we had a client that was a substantial private equity fund that had a dispute with its investee. As you might expect, private equity funds don't think it's a good idea to be on record as suing their investees, or then they face the possibility that investees might not want to take their money in the future.

They had a narrow legal issue about how to interpret a particular provision in their certificate of incorporation. And when we worked with them, we said, "Look, you could bring this litigation publicly and you could spend a lot of money and a lot of time getting to an answer. But honestly, if we get the other side to agree that we won't sue you, and in exchange for not suing you, we'll get to a quick, arbitrated resolution before a sitting member of the court, that's really in everybody's interests."

It's in everybody's interests because (a) we can do it in ninety days, (b) we can agree what this proceeding will look like, and (c) if we set it up just so, we won't need to go through a preliminary injunction phase, which because this was transactionally-based, we would have done had we litigated.

JOHN MARK ZEBERKIEWICZ: The situation I described was one in which the parties had a good-faith disagreement over the construction of a particular term. The language in question, like the language in virtually any document drafted many years ago, with benefit of hindsight, could have been drafted better.

I don't believe that either party, in this case, thought the other was venal or acting in bad faith or taking a frivolous position. Both parties understood that they had their construction of the provision, the other side had their construction of the provision, and the judge was going to pick one or the other. Both sides were at an impasse. Neither could convince the other of its reading. They need a court to settle the matter.

Had that gone through litigation, it would have taken far longer than arbitration proceedings ultimately took. In less than sixty days, the parties had submitted briefing and participated in a hearing before the chancellor.

GREGORY VARALLO: It would have cost the client five to ten times what it cost with this regime.

JOHN MARK ZEBERKIEWICZ: Easily. As it turns out, we filed our brief, they filed their brief. There was no discovery. We went before the chancellor (which, incidentally, was the morning on which the Delaware Coalition for Open Government filed its complaint). During that hearing, the parties got a fairly clear indication from the chancellor how he was approaching the issue. As a result, within a few days, the parties settled the dispute. The rest is history.

GREGORY VARALLO: And in terms of customizing, again, we gave up the right to file motions, we gave up the right to appeal, and we gave up the right to discovery. We just said, "Hey, we need a judge who can tell us what the legal answer is here."

We trust these judges because they are—they have a well-deserved reputation. And after filing briefings, just like you would on a motion for summary judgment or a motion to dismiss, we went in and argued the case without a factual record, just on the law. And as John Mark said, we effectively had an answer from the bench, and the parties resolved their differences within about a week.

JOHN MARK ZEBERKIEWICZ: Yes, within a week.

GREGORY VARALLO: That's one end of the spectrum that we've been involved with. The other end of the spectrum looked and felt much more like a trial. There was a pending case in the Delaware Court of Chancery, a publicly-filed breach of fiduciary duty case arising from a private equity firm's financing of an investee company, but it was public.

And there was, I think, a strong interest on the part of both parties to get it resolved as quickly as possible. We were the defendants in the case, and we said to the plaintiffs, "Look, we're willing to convert this into one of these private arbitrations in chancery. And what you, the plaintiffs, will get out of it is a resolution in ninety days. Do you want more? We're willing to waive our right to move for summary judgment or to dismiss your complaint. So not only do you get a result in ninety days, but you get a result in ninety days that goes right to the merits. We're going to go take discovery. We're going to put on a hearing before the arbitrator just like we would in trial, and we're going to be done. And, oh, by the way, we want both sides to waive appeal."

As strange as it sounds, both sides to the matter perceived benefit in that. And the benefit, the plaintiffs thought they were going to win. They thought they were going to win money and a lot of it. And the benefit they perceived in it was getting to a non-appealable resolution in ninety days and getting their money very soon after ninety days.

From the defendant's perspective, we had limited insurance coverage. Frankly, if we had gone to full-blown litigation, it would have cost us a couple of million dollars to do it, to bring it through full case and appeal. And the thought was, let's get an answer as soon as possible, and if we're wrong, there will be some insurance money left over to help pay the judgment as opposed to exhausting the insurance money with the lawyers.

That's exactly what we did. It turned out to take about one hundred twenty days rather than ninety, so we simply agreed, and we went back to the judge and said, "We need another thirty days, judge, to get this done." The judge was more than happy to do it. We put hearing witnesses on. We went through about three days, and the judge called the proceeding and said, "I'm ready to decide. I don't need to hear from any other witnesses. Verdict for defense."

So we then played around with an interesting question—Under a new regime, how do you go about making that verdict, entering it on the docket of the court, and entering it consistent with the need to keep it but still protecting your client, so that if a frivolous case was brought later on the same facts, you could claim *res judicata* protection?

As it turns out, we found out sort of by stumbling around and filing—attempting to file a case to enforce the judgment that we didn't need to do it. The chancellor told us privately that all we needed to do was go back to the vice chancellor who was our arbitrator and that that arbitrator would switch hats from arbitrator to vice chancellor of

the Court of Chancery and sign a piece of paper called a judgment that could be filed on the docket of the court.

The judgment said, “Judgment for defendants and against plaintiffs.” That’s all it said. It had the caption of the case. It was a one-liner. He signed it, entered it, and since it was not subject to appeal, it became final. The other side took its lumps, and we all went home happy having done it in about one hundred twenty days.

The third and fourth cases, really flipsides of the same case, I think were a little bit more interesting from the point of view of whether this kind of dispute resolution works all the time. Because these kinds of alternative dispute resolutions get triggered by the parties’ prior agreement in writing, we began to put these into merger agreements thinking that it would be a neat way to resolve things like earn-out disputes, escrow disputes, or other deal-related disputes.

We also began to put them into public company M&A documents, and we wound up with a fascinating dispute almost exactly a year ago where two public companies had agreed to merge, and prior to the merger closing, prior to the stockholders’ vote which led to the merger closing, the companies realized that there were some issues particularly relating to the target’s accounting, and the buyer decided it didn’t want to go forward and claimed a breach of representation and warranty under the merger agreement pertaining to the target’s accounting.

It gets interesting real quickly when you’re both public companies subject to the Securities Exchange Act of 1934 and are required by federal law to make disclosure of material facts to your stockholders. Because this particular deal was public on both sides and because the question of whether the deal would go forward at all was at issue in the underlying arbitration, both sides thought it was critical that they disclose the existence of the arbitration, and broadly, without being very specific, describing broadly what the arbitration was about. Both sides did that.

My client had a registration statement on Form S-4—and I’m sorry if I’m boring the non-securities lawyers in the group. But when you issue stock to do a merger, you need to get it registered under the Securities Act of 1933, and you do that by filing something called a registration statement. This particular thing was a registration statement on Form S-4.

That’s important for only one reason, and the one reason is a registration statement, when filed and effective, incorporates by reference the other side’s, the target to the merger agreement’s, financial statements.

So we were a buyer filing a registration statement to register stock to issue in connection with this merger, and we had our target's financial statements in that registration statement. But in the private arbitration, we were taking the view that those financial statements were false, misleading, and otherwise not in compliance with GAAP.

So a securities lawyer would tell you we were effectively between a rock and a hard place because under the law, once we filed that registration statement, our stockholders are presumed to be entitled to rely on its correctness, including everything incorporated by reference there.

We could not allow that to happen while at the same time privately arbitrating the question of whether those very financial statements were or were not accurate. And we found ourselves grappling with extraordinarily difficult issues pertaining to how to go about making disclosures, which were fair to the arbitration process, which has at its core privacy, and also keeping in compliance with our federal law obligations.

And I will tell you that the views of the buyer and seller on what was absolutely required were quite different. Seller took the view that no disclosure was required. Buyer took the view that it either needed to withdraw the S-4 or to make disclosure that stockholders were not permitted to rely on the financial statements in it.

That led to a fairly nasty fight in the arbitration, and the arbitrator, being a creative guy, came up with a fascinating way to deal with it. He ordered that my partner, who is a securities lawyer, would be appointed effectively as a special master of the court and that my client was not permitted to make any federal disclosure without first presenting it to my partner, convincing my partner that it was required and having my partner file an affidavit with the court saying that he had reviewed the proposed disclosure and concluded that it was required by law.

Interestingly, we stopped making disclosure. The long and the short of it was literally on the eve of the arbitration hearing, which was within ninety days, the parties renegotiated their deal and everybody was happy and the deal closed.

But it pointed out to us, I think, the limits of private arbitration. And while there are many kinds of disputes in a public deal where private arbitration works just fine, I have a question in my own mind anyway as to whether it works as well where what you're trying to do is renegotiate or end the deal because of the disclosure overlays.

JOHN MARK ZEBERKIEWICZ: I think in a public-public material adverse effect (MAE) contest, where you have parties fighting

over whether the deal should go forward, given the overlay of federal securities laws and the amount of disclosure that needs to be made, it does seem to me that the confidentiality component of the arbitration procedure is almost certain to complicate matters. And that is perhaps an understatement.

MAE litigation, by its nature, is hard-fought and intense, as well as fact-sensitive and fact-intensive. In most cases, it is probably beneficial to go through the full-blown discovery process. Personally, I'm not convinced that the arbitration procedure is ideal for all disputes under a public-public merger agreement.

I do think, though, that it does have a place in private company disputes over various types of transactions or contractual disputes. There is a lot of value in whittling down all of the noise and focusing on what is really at issue. And the parties can do that before they have even presented the matter to the court.

Earlier, Greg mentioned escrow disputes. Those disputes have a tendency to get highly contentious. If you could limit the number and types of disputes in an arbitration proceeding, the parties could save a lot of time and effort and reach a far better outcome.

GREGORY VARALLO: I'm eternally hopeful and I hope that in the future, assuming we are back in business in this area, that we'll be able to design arbitration parameters that make sense for that necessary public disclosure. Obviously, we're all imperfect, and as we sort of stumbled through it the first time with a judge doing what he needed to do in trying to bring some sense and order to it, we had this very weird hybrid procedure of sort of special master, sort of disciplining our disclosures as we went.

Maybe not the best possible solution long-term, but it tended to work in that case, and I have great faith in the ability of creative people to come up with creative solutions to difficult problems.

JOHN MARK ZEBERKIEWICZ: Again, in private company mergers, it would be ideal.

GREGORY VARALLO: We just confirmed in the Court of Chancery the largest arbitral award ever given in Delaware. For those of you of a certain age, you may remember *Guitar Hero* and *Rock Band*. Well, they were, at the time they were published, the most successful software games ever published. I think since that time, *Call of Duty* and *Black Ops* have sort of leapfrogged over them, but when *Guitar Hero* and *Rock Band* came out, they were the biggest selling software games ever.

There was a company called Harmonix that owned those software games, created those games, and sold to Viacom. Obviously,

Viacom's in the entertainment business. And just like every single movie dispute where the movie makes a billion dollars and the talent who has a piece of the movie is told that the movie lost money, surprisingly, Viacom concluded that *Guitar Hero* and *Rock Band* lost money. So the parties had an earn-out on the backside of the deal.

Viacom concluded after originally paying out \$150 million, very publicly concluded that it was wrong, and it wanted its \$150 million back. So they sued all 110 stockholders in Delaware, which was kind of fun, and we then proceeded to effectively arbitrate before so-called resolution accountants the amount of this escrow, and the resolution accountants concluded about three months ago that not only did Viacom not get its \$150 million back but also, in fact, it owed an additional \$350 million.

And that was brought to the chancery court for confirmation of judgment. The chancellor confirmed the judgment, and we're before the Delaware Supreme Court on the narrow FAA issues on whether the chancellor effectively fell off the turnip truck or not. As the proponent of that award, I daresay I believe that the Delaware Supreme Court will affirm with all due haste the chancellor's most excellent opinion.

So as we went through these four or five original arbitrations in Delaware, we sort of came to the conclusion that the system, while it was very well-designed, wasn't perfect. And so we began thinking about how we could make it better and published an article⁹ not too long before the darn thing was enjoined putting a form out there and saying, "Look, here are the things we found that could, in fact, be better." That form is in your materials, and I'll yield to John Mark to walk you through this.

JOHN MARK ZEBERKIEWICZ: This goes to one of the points that one of the speakers earlier had made. I am principally a corporate advisory attorney. Greg is a corporate advisory attorney, and he is also a litigator and a very fine one at that. But he and I did actually work together on this.

I started off with a basic form arbitration provision that I'd used in other agreements. Greg then went through it, based on his experience and his knowledge of the rules, and he added in various places the ways in which parties could modify the provisions by reference to the rules. He also added a few elements to address the typical traps-for-

9. Greg Varallo et al., *Chancery Arbitrations After Year One: Annotated New Form*, AM. BAR ASS'N (Aug. 16, 2012), <http://apps.americanbar.org/litigation/committees/commercial/articles/summer2012-0812-chancery-arbitrations-annotated-new-form.html>.

the-unwary circumstance. He highlighted those situations to ensure that parties were focused on them—such that they would not go undetected or unconsidered.

In annotating the form, we attempted to explain what we were doing in the text of the provision and why we were doing it, making reference to the rules on which the provisions were based. The form starts off within a basic agreement to arbitrate. In this case, obviously the parties would agree to arbitrate pursuant to the arbitration law and rules that have now been declared unconstitutional, at least for the moment.

GREGORY VARALLO: Let me just jump in here for a second. We're going to go back and forth as we go. I just finished negotiating a month-long—literally it took us a month to negotiate an arbitration agreement, and the guts of that arbitration agreement we took the month to get to was defining precisely the issues that were going to be arbitrated.

The professor mentioned that as a way to save money, and I couldn't agree more. I think there's almost nothing more important than getting both sides' minds around what it is that actually is going to be arbitrated. It literally took us a month to come to that conclusion, to write it down, and to agree on the words. It was complicated, but it shouldn't have taken a month. It did.

Obviously this first paragraph doesn't go into the specific issues that are going to be arbitrated.¹⁰ Like any form, you need to work with this and expand or contract it as appropriate for your client. But don't miss the idea here of identifying precisely what it is you're arbitrating about and dumping it in here.

JOHN MARK ZEBERKIEWICZ: This form—obviously it contemplates that it would be part of an agreement, and it's a very broad arbitration provision.¹¹ The parties could narrow this in scope. For example, if this were included in a merger agreement and if the parties didn't want it to apply to every element of the merger agreement, but rather only to the escrow provision or to whether or not a particular condition has been satisfied, the parties would have the flexibility to do that. Because this is a form, it refers to any dispute or controversy arising out of the agreement and the transactions contemplated thereby.

10. *Form of Arbitration Provision*, *supra* note 8, at 1.

11. *Id.*

Another feature of the first clause is that the parties agree not to object to the submission of the dispute to arbitration.¹² It is very important to make sure that the parties irrevocably waive that objection to the fullest extent permitted by law. Once the parties are in arbitration, there's no backing out.

Moving to the next provision, the form gets into the rules and how they will be applied.¹³ This form starts from the premise that the arbitration is going to be "conducted in accordance with the Chancery Rules pertaining to arbitration, [except that the parties agree that Rule 97(f) of the Chancery Rules shall not be argued or construed to abridge the right of any party to take discovery pursuant to Rules 26 through 37 . . .]"¹⁴ Greg, do you want to translate that into English?

GREGORY VARALLO: Yeah. In plain English, Rule 97(f) gives the arbitrator the right to limit or condition discovery in the arbitrator's judgment.¹⁵ We had a matter where the parties had not agreed to limit the number of depositions looking forward to a final arbitration hearing.

The arbitrator took the view, the chancellor took the view that Rule 97(f) gave him the ability to put a limit on the total number of depositions that were used by the parties, and he did put such a limit on it. By taking Rule 97(f) out of here, assuming you're using the Chancery Rules, you're giving yourself the right to say, "We're going to take as many depositions as we need to, gosh darn it."

However, if you are focused on a matter in which you need to control costs, certainly one of the things you might want to think about is instead of going this direction, say, "No, instead, we're going to have three depositions a side or five depositions a side, whatever you decide to do." But this is designed expressly to take away from the arbitrator the power to tell you how many depositions you will take.

JOHN MARK ZEBERKIEWICZ: Next, the form provides that arbitration shall take place in Wilmington, Delaware.¹⁶ Greg, is there any particular reason we selected Wilmington?

GREGORY VARALLO: I prefer Paris myself. The problem with Paris is that the judges who are arbitrators are public servants and they have busy calendars in Wilmington, and as much as they'd like to go off to some exotic, foreign locale, they can't.

12. *Id.*

13. *Id.* at 1-2.

14. *Id.* at 1.

15. DEL. CH. CT. R. 97(f).

16. *Form of Arbitration Provision*, *supra* note 8, at 2.

JOHN MARK ZEBERKIEWICZ: If we were talking about one of the vice chancellors in the lower counties of Delaware, we may not be able to get our blessing in that provision or our request in that provision.

GREGORY VARALLO: I think for purposes of our contract, we would say this, and then to the extent we had Sam Glasscock or one of the downstate vice chancellors, we would simply agree to move the locale to a place convenient to the arbitrator.

You don't need to know this, but Delaware's a small, little state. It's only a couple miles wide, but it's about 110 miles long. And at the very bottom of that 110 miles is a place called Georgetown, Delaware, which is the county seat of one of the three counties.

Wilmington's about as far from Georgetown as you can go in Delaware, and so asking—if you wind up with that judge as arbitrator, asking him to come to Wilmington for what could be a week-long hearing is a little bit of an imposition on him, and we would typically go down and visit with him and spend some time with the good citizens of Georgetown.

JOHN MARK ZEBERKIEWICZ: The following clause provides that the arbitration shall be presided over by an arbitrator who shall be a chancellor or one of the vice chancellors.¹⁷

GREGORY VARALLO: Let me interrupt there one second. The statute and rules contemplate also that the chancellor could appoint a master in chancery as an arbitrator. In our view, the benefit of this regime is getting one of the five rock star sitting judges as opposed to one of the two non-rock star junior judges called masters in chancery. So we don't include master in chancery here.

With all due respect to the masters, they're both doing a great job and they are junior rock stars. They'll one day be full-fledged rock stars. I know we're on the record, so I want to make that apology. Go ahead.

JOHN MARK ZEBERKIEWICZ: The next provision provides that any issue over whether, or the extent to which, the dispute is subject to arbitration shall itself be decided exclusively by the arbitrator.¹⁸ Even though it seems relatively innocuous, this is actually a fairly important clause. Whether or not whatever the parties are submitting before the arbitrator is subject to arbitration should be a matter for that arbitrator to decide.

17. *Id.*

18. *Id.*

GREGORY VARALLO: And this is—when you get into arbitration, you spend some time learning the area. There's a difference between substantive arbitrability and procedural arbitrability—I have a hard time with that word—in the law. And state-by-state, the law differs as to who gets to decide which of those issues.

The Delaware law on this particular issue is extremely complicated, and frankly, less than a model of clarity. And the purpose of saying that the arbitrator gets to decide what is arbitrable serves an important substantive purpose of making sure that your arbitrator is deciding all issues and nobody has a right to run to court to decide whether something is or isn't within the scope of the arbitration.

Of course, in this particular case, if the arbitrator is a sitting member of the court, you could conceive of him or her simply changing hats and putting their judge hat on to make the decision. But for purposes of clarity, we wanted this in here, and it's important if you're under Delaware law, that if you want the arbitrator to decide what is arbitrable, that you expressly say so in your contract.

JOHN MARK ZEBERKIEWICZ: Next we go to something that we've been talking a lot about, and that really is that the arbitral award shall be rendered within ninety days after the request for arbitration is submitted.¹⁹

Now, recognizing, as you indicated earlier, this is aspirational from the get-go. Our experience so far has suggested that it is not only possible but also likely that the parties can complete the process in ninety days or less. Perhaps that will have to get kicked out in some cases to one hundred twenty days.

But, for the right type of dispute, the process can be concluded very quickly. The chancellor and the vice chancellors are incredibly responsive. It's unlike any other place that I'm aware of. There is an enormous benefit to the Delaware court system, and I think this clause (e) that sets forth the timetable in which the parties are anticipating resolving the dispute is one of the most important features of the entire regime.²⁰

Next, the clause includes numerous provisions dealing with how the award will be rendered: whether it's going to be a written award and whether the parties would like to have the chancellor or the vice chancellor articulate the basis for the ruling.²¹ In some cases, the chancel-

19. *Id.* at 2–3.

20. *Id.*

21. *Form of Arbitration Provision*, *supra* note 8, at 2–3.

lor or vice chancellor could rule from the bench. In other cases, the parties may want to see the reasoning in a written opinion.

It's really a matter of how the parties want to proceed and intend to address subsequent matters. Greg, do you want to address the circumstances under which the parties would want to have the order reflected in writing, along with the reasoning?

GREGORY VARALLO: Sure. I think there are two circumstances. One is if you want to make the award appealable. That is to say, if you don't want to waive your right to appeal, it usually is useful to have some statement of reasoning to be able to argue on appeal in case you've lost.

The other reason you would do it, I think our luncheon speaker referred to the idea that sometimes clients need to say their piece and be heard and sometimes clients need to have a judicial officer or an arbitrator or a neutral make a ruling on whether they're right or not, and if they aren't right, why aren't they right.

I think the more you do of this, both in litigation and in alternative dispute resolution, the more you come to the conclusion that about three-quarters of what we do is cathartic, psychologically cathartic, that is to say, giving people their so-called day in court, their opportunity to express their views. And I think if you sense you have a client who needs not only to know what the answer is but why, you would put a provision in here asking for written reasons.

JOHN MARK ZEBERKIEWICZ: As you mentioned, if the parties preserve the right to appeal, they will almost need to have something in the agreement that requires or attempts to require some type of written opinion.

And that leads to the next provision: whether or not the parties will have the right to appeal.²² This is one of the most important decisions that the parties will need to make at the outset. If the parties go in with the idea that this is going to be just one shot, where they'll put their best foot forward, they've got to be willing to live with the consequences of that decision. Because when it's done, it truly is done.

GREGORY VARALLO: I would say that actually in this chancery regime, it has been an easier sell than I thought it would be to sell the idea of waiving appeal. And I think good counselors—and I'm assuming that you know the law when you're counseling here—start by explaining to their clients that an appeal from an arbitrable award would proceed pursuant to the statute that this is all arising under, the FAA. And under the FAA, as you all know, there are very narrow grounds

22. *Id.* at 3.

for appeal. There are grounds for appeal, but they're exceedingly narrow.

I don't have it in front of me, but there's one prong of the federal appeals—FAA appeals standard that effectively they so misconstrued the law that you couldn't possibly be right, my version of it. But it's very, very hard to prevail on an appeal under the FAA on application of the law, so long as some version of applicable law was actually applied.

So I think you start by explaining to your client that while you do have appellate rights, they're narrow, and they are effectively the escape valve, the pressure valve for the entirely inappropriate, entirely wildly wrong arbitration result—the wholly unexpected result.

If you're in the Court of Chancery arbitrating, you, by definition, unless the chancellor has some serious problem, you, by definition, are not ever going to get the wildly wrong result, never going to get the result that would give you grounds for appeal effectively. Not to say you won't appeal, but not likely on good grounds under the FAA.

So at least from my point of view in counseling clients through this, waiving your right to appeal is a relatively small give if you're being asked to give it. And if you are on the fence as to whether to do an arbitration and timing matters to you, even fast appeals in the Delaware Supreme Court take about three to six months.

They commit to the public that they'll process an appeal within ninety days of the date it is finally submitted either on briefing or argument, but the typical brief schedule is thirty, thirty, thirty, so you're about one hundred eighty days in the typical appeal. There are plenty of matters where clients value final, non-appealable decisions within ninety days over the theoretical possibility that the chancellor totally loses it and commits error that is so gross that it is overturnable and appealable under the FAA.

JOHN MARK ZEBERKIEWICZ: Next, the form provides broad authority to the arbitrator to grant any equitable or legal remedy, excluding punitive or exemplary damages that would be available in a judicial proceeding including entering injunctive relief.²³ There are a couple of issues to note here. One, the form excludes punitive damages because they are not available in the Delaware Court of Chancery. Next, the form provides that the arbitrator has the ability to enter injunctive relief. Greg, could you limit injunctive relief in the agreement, and could you provide for punitive damages?

23. *Id.*

GREGORY VARALLO: I think you've got a constitutional issue on punitive damages because while the chancellors are sitting as arbitrators, chancery is not authorized, equity is not authorized to grant punitive damages by constitution. And on—I'm sorry, what was the second question?

JOHN MARK ZEBERKIEWICZ: The second question is whether you could limit, or request that the court limit injunctive relief and just focus on, let's say, damages.

GREGORY VARALLO: I think it's certainly possible to ask the court to limit the remedies that he or she grants as arbitrator. My experience with that outside of arbitration has not been very good, and typically what I mean is if you're doing a simple contract and the contract says parties waive any requirement for posting of a bond and harm's going to be irreparable in this particular deal if it's breached and, oh, by the way, the court should grant specific performance to remedy the irreparable harm if this happens.

You know, the court looks at that, and says, "Oh, thank you very much, that's all very interesting. But I'm an independent judicial officer, and I've got to determine that there's a record, and I've got to determine that there is, in fact, irreparable harm and the basis on which to grant the relief you want." So even though you might stipulate to it by contract, at least in a Delaware equity court, it is not uniformly granted simply because you stipulated to it.

JOHN MARK ZEBERKIEWICZ: Which, of course, is why the enforceability opinions contain carve-outs for that.

GREGORY VARALLO: So you've had securities law and you've had opinion granting here. Could it be any sexier? Could it be any better?

JOHN MARK ZEBERKIEWICZ: Nothing but glamour from the guys in Delaware. Next, the form proceeds to its most controversial provision, the confidentiality clause.²⁴ This form does provide that the parties agree that, subject to any non-waivable disclosure obligations under federal law, all will be confidential.

And that was, up until this was enjoined, one of the real benefits of this regime. The parties could proceed on a confidential basis and have their dispute resolved quickly and quietly, outside of the view of the paparazzi. A lot of parties don't like to have their dispute made public for a variety of reasons. Perhaps they are high-profile people who don't necessarily want to have their disputes made known to the entire world.

24. *Id.* at 4.

GREGORY VARALLO: Let me articulate that a little bit more finely. One of the things we do in Delaware is litigate broken deals when they break or are about to break. And John Mark mentioned earlier the so-called MAE or the material adverse change clause. That's right up there with securities law and opinions.

But basically what it means is, I'm buying your company. We're both public companies and something's happened that's so bad that you're now a different company. I want to be relieved of my contractual obligation to buy you. So you're in contract, this happens, and you decide you're going to go and litigate it. Well, when you're litigating it in public, you're making a public record of the company you are about to buy being so badly broken that you don't want to buy it anymore. If you lose that case and you are enjoined to close the deal, which has happened—the Tyson Foods case resulted in an injunction requiring close when the buyer tried to back out. The market has—you know, all those analysts that set stock price and affect how your price trades, the market knows that you have just bought something that you think has serious financial problems associated with it, in fact, so serious that you wanted to walk away from the deal. Guess what that's going to do to your stock in the market when that comes together?

And so from the point of view of public company deal litigation, this was perceived, at least at first, as a very attractive alternative because to the extent you have to argue that your target's accounting, for example, is not only violative of GAAP but perhaps even fraudulent and needs to be restated, it would be kind of nice to do that in a way that doesn't make a record.

Because if you are forced to continue anyway, guess whose accounting is now going to get restated when you merge that company into you? It's probably going to cause a restatement. Whether or not the Securities and Exchange Commission looks to the chancellor's decision, if the Securities and Exchange Commission decides that you were close enough to being right about the accounting of the target, that now your accounting is tainted, that's a real mess.

So there are lots of times—now, I know I said earlier that it's very difficult to manage your public disclosure obligations with the goal of keeping these private, but to the extent you're doing busted-deal litigation, there certainly is a very big plus on the side of doing it privately if you possibly can.

JOHN MARK ZEBERKIEWICZ: Next, the form goes to the issue of fees.²⁵ In this form, each party bears its own legal fees and costs. That's generally consistent with the American rule, except the form states that each party pays one half of filing fees, and fees and expenses of the arbitrator.

Greg, do you want to talk about how the court's fees were structured for the arbitration regime generally and whether this was a situation where the court was using a lot of state resources to establish and operate this new process and regime?

GREGORY VARALLO: The fee structure actually was substantial. The initial filing fee, I believe, was \$12,000 to start one of these things split between the parties. And each day of hearing or other judicial activity or arbitrator activity, I think, was \$6,000.

The judges varied a little as to when they imposed that additional \$6,000. One of them charged you the \$6,000 for every motion, whether it took half of a day or half of an hour. One of them only charged the \$6,000 for the actual hearing of the arbitration itself. So there wasn't perfect uniformity about how they were doing that. That's something that obviously will get ironed out as we have more experience in this.

But in my experience, these typically wound up costing between \$25,000 and \$30,000 all in for the arbitration fee. I'm not talking about your fees. I'm talking about the fees you paid to the state. If you do some quick math, we had six of them at \$30,000 apiece. That roughly paid for one of the chancellor's entire year. So this is not an insubstantial additional revenue generator for the state.

JOHN MARK ZEBERKIEWICZ: Next, the form includes an acknowledgment from the parties that the arbitrator may impose rules different from or in addition to those set forth in this section and that nothing shall be construed to limit or restrict the arbitrator's power to impose such rules.²⁶

The bracketed clause states that, with respect to some of the rules, the parties really don't want the arbitrator to vary them.²⁷ That one may have an aspirational element to it. But, in most cases, if the parties are reasonable, I would venture to say that the arbitrator would follow suit. To the extent the parties get out of hand and try to tie the arbitrator's hands, that may not go over so well.

25. *Id.*

26. *Form of Arbitration Provision*, *supra* note 8, at 4-5.

27. *Id.*

GREGORY VARALLO: I think that's good advice. I will say, though, that the first full-blown one of these that was not a truncated one that actually went to final hearing, the vice chancellor acting as arbitrator on the first conference said, "Look, folks, I view this as the ultimate in customizable jurisprudence. So whatever you want to do, as long as it's consistent with law and good taste, I'll let you do. As long as both sides agree, whatever you say the rules are for how this is going to run, I'll run it that way," and he was true to his word. He did exactly that.

JOHN MARK ZEBERKIEWICZ: I think that's right. I think it's customizable within bounds of ordinary reasonableness and rationality.

GREGORY VARALLO: Let me focus on one other point of this provision, and you can tell who the litigator and who the corporate guy is because he went right past the rules.

In the second paragraph, John Mark, this is section (b) on the first page, the parties expressly opt into Rules 15, 41, and 45.²⁸ Once again, we parallel the FRCP. So those of you who are quick will realize that's Rule 15 (amendments), Rule 41 (dismissal), and Rule 45 (subpoenas, third-party discovery).²⁹

What we found in one of these cases was we sought to have the arbitrator issue subpoenas to third parties who weren't parties to the arbitration. Frankly, we wanted to take the outside accountants in a case involving accounting. And the arbitrator took the view—one of the members of the court took the view, which I thought was very interesting, that third-party discovery by its nature was in contravention of the overriding privacy that is in the act and in the rules.

And it would be impossible to issue a subpoena to a third party to give discovery without telling them, for example, why the subpoena was coming, in what case it was pending, what the names of the parties were, and thus disclosing, for example, the fact that there was a dispute between petitioner and respondent.

So the chancellor, acting as arbitrator, declined to issue a subpoena, and we lived with it. I mean, we dealt with that, but we learned from it. And in cases where you believe, at least in chancery, that it's necessary to—it's going to be necessary to talk to third parties, investment bankers, accountants, auditors, that sort of thing, it would be wise, at least in my view, to include a Rule 45 reference so that the arbitrator

28. *Id.* at 1.

29. Compare DEL. CH. CT. R. 15, 41, 45, with FED. R. CIV. P. 15, 41, 45.

understands that the parties contracted for and contemplated the ability to subpoena third parties.

Rule 15. Interestingly, the way the rules are set up, there's no provision for amendment. There's a petition, there's a response, and then you just go. Now, typically where you're going from start to finish in ninety days, there's not going to be a lot of room for amendment. On the other hand, if you get quickly into the matter and find out that you want to somewhat change or redirect the focus of your main claims, not having an ability to amend could put you in a situation where, at final hearing, the other side stands up and says, "This is all very nice, but we weren't put on notice of it in the initial claim and we want the opportunity to postpone or we want it barred" or whatever relief they would want.

And so we, again, sort of stumbled into this, but we realized as our theories changed ever so slightly that we ran the risk of being told that we hadn't given fair notice to the other side of what our claims were and therefore having our new theories barred. So we thought it was wise to include Rule 15 allowing amendment.

And finally Rule 41, to dismiss in the event that for whatever reason one party or another wants to dismiss short of the final hearing with or without consent of the other party. Again, they parallel the federal rules. So if you think of the federal rules, you'll sort of see what we're talking about.

JOHN MARK ZEBERKIEWICZ: The next provision deals with collateral attacks.³⁰ Greg, you alluded to these earlier. Do you want to provide more color on how that provision came into existence and why we suggested including it in our form?

GREGORY VARALLO: So those of you in civil procedure class or who have had civil procedure class understand that there's a doctrine called *res judicata*, a doctrine called collateral estoppel, and I'm never quite sure what the difference is between them, which is my lack of proper upbringing.

But at the end of the day, after you've litigated a matter to final judgment, you're supposed to not have to litigate the same matter again, right? Because you get a judgment. And when somebody sues you on the same facts and theories and/or facts and theories that could have been litigated in your original case, you plead bar by judgment, *res judicata*, collateral estoppel. You file the judgment, and hopefully the second court dismisses the case and you get the value of your judgment. You get the benefit of your judgment.

30. *Form of Arbitration Provision*, *supra* note 8, at 5.

The problem is when you've got a private arbitration regime and it's private from start to finish. If there are facts or circumstances that are necessary to establish the bar of *res judicata*, at least as between the parties to the arbitration, and there's no judgment on file that says those facts and circumstances, that doesn't lay it out anywhere, assuming for purposes of argument, your counterparty acts poorly and brings a new claim claiming exactly the same things it just lost in private arbitration, in a public court, how do you convince the public court consistent with your undertaking of confidentiality that this has already been effectively arbitrated and that *res judicata* should apply?

And so we crafted (i)³¹ when we were sort of thinking through how to protect our client that we had just won the arbitration for when we didn't have clear rules on point. We crafted (i) as an opportunity such that if the other side brought a subsequent litigation which they shouldn't have brought, you were relieved of your confidentiality obligations to the extent necessary to make the second court aware of what was, in fact, arbitrated and so as to allow you to plead *res judicata*, collateral estoppel.

JOHN MARK ZEBERKIEWICZ: The next two provisions are the provisions that I would refer to as the "thank God we thought of this when we did" provisions. As an aside, I had included a form along these lines in an agreement that was entered into shortly before the entire regime was declared unconstitutional. Clause (j) is basically a savings clause that would have provided that, if any provision of section 349 was found to be invalid on the confidentiality grounds or if any other confidentiality restriction would have rendered the whole thing invalid, then that would have been severed from the agreement.³² Clause (k) was basically that if the court ceased to conduct arbitration proceedings pursuant to section 349³³—I guess it didn't cease so much as . . .

GREGORY VARALLO: It was just enjoined.

JOHN MARK ZEBERKIEWICZ: It was enjoined, but nonetheless, I'm going to read ceased to mean enjoined. That basically provides an alternate method to have the suit arbitrated or have the case arbitrated.

In retrospect, we were very fortunate to have included these savings clauses. A good piece of foresight on our part, although I'd far prefer that the regime were still in effect.

31. *Id.*

32. *Id.*

33. *Id.* at 6.

GREGORY VARALLO: So by way of news from the front, as I mentioned, we just signed up an arbitration agreement within the last week or so. It was an agreement—it involves some very well-known parties who didn't want to publicly litigate, but who were heading towards public litigation.

And the same dynamic. We agreed to non-appealable, ninety-day arbitration. We effectively copied what a chancery arbitration looked like, and what we agreed, because we couldn't use a sitting member of the Court of Chancery. We're blessed in Delaware with two recently ex-members of the Court of Chancery. They both retired in the last two years.

We agreed to use an ex-member of the Court of Chancery on the theory that they were both au courant with the Delaware law and were responsible jurists who would behave as though—almost as good as a sitting member of the court.

So what we're doing today is we are trying to replicate this regime as closely as we can using former judges. But we'd very much like to be in a position to get back to using the sitting judges if the injunction is lifted.

Questions? Let's talk. We have a few minutes. Do any of you have questions about how this works, how it might be better, what worked for us, what didn't work for us, how to make your regimes better in AAA or chancery?

AUDIENCE MEMBER: Kind of a policy consideration using judges as arbitrators. In regards to what we've talked a lot today about how the trial court system is failing companies because of its inefficiencies and inability to resolve things in a timely manner and mitigate, I guess, the financial impact of certain judgments. But to what degree are we just contributing to the problem more by taking judges away from their traditional roles and using them in an arbitration system that's primarily been relied upon because of the inefficiencies in traditional litigation?

GREGORY VARALLO: Do you practice in Cook County?

AUDIENCE MEMBER: I'm a third-year law student, but yeah.

GREGORY VARALLO: So we live in a different world. We're the Liechtenstein of America. It is an entirely different system in Delaware than literally anywhere else in the country, and I've had the good fortune to try cases in Massachusetts and Arizona. I've argued to Judge Aspen out here a number of years back. And I've just had the opportunity to see the inside of courtrooms all over the country.

There's nowhere like Delaware. These five judges are incredibly hard-working, very civic-minded individuals. And in my thirty years at the bar, the court has grown from three to five judges as the volume of cases has grown. They are all very busy. They turn out long opinions.

But unlike elsewhere in the country, most of the work chancery does is in the context of expedited deal litigation where you need an answer four or five days after, sometimes two or three days after, it's presented to the court. And these are judges who deal after deal after deal will turn out forty-, fifty-, and seventy-five-page opinions within a day or two of the matter having been argued.

They don't have the typical criminal or family law or auto accident cases on their docket. Because they are a specialized equity court, they only hear matters assigned to them by statute or which traditionally have been matters heard in equity.

So if you want equitable relief like an injunction or specific performance, you can go to the Court of Chancery. So it's a court of limited jurisdiction to begin with. While they are quite busy and while they work intensely hard, our experience with the first group of these arbitrations to move through the court was that you couldn't tell any difference in the output. There certainly was no delay in matters.

JOHN MARK ZEBERKIEWICZ: I think the other thing to keep in mind, too, is that these are matters that would have otherwise just been filed as cases in chancery and would have taken up probably more of the court's time as actual cases filed in chancery.

GREGORY VARALLO: And I think the other thing you see is we've got this really unique working balance between the judiciary, the bar, and the legislature that we reflected, I think, in talking about the amendment process for our legislation.

But when it is necessary to authorize a new judge for the court—and it's happened twice during my career—the bar goes to the legislature with the chief justice's approval and says, "Hey, we need another chancellor and here's why: the average caseload has gone from here to here," so forth and so on. To the extent that these kinds of matters became more active and took some number of judges out of the pool who were otherwise available to do the litigations, putting aside the point John Mark made which is they would be litigating anyways, to the extent that happens, the Delaware response is very, very clear. We'll just add another member to the Court of Chancery.

Remember these are generating between \$25,000 and \$40,000 per filing, and so from a state revenue point of view, we're going to be more than able to keep up with the cost from a state budget point of

view of additional judges. And it's very hard to—I grew up outside of Delaware. I wasn't born there. I went to school in Philly, and I came to Delaware. It was this cute little place.

And it took me a number of years to really get it, you know. But in a small state where 25% of your entire revenue base is the legal industry, broadly defined to include the courts and what they do and the law firms. With that impact on your bottom line and with both the legislature and the executive focused on that being the impact on the bottom line, the state does whatever is necessary to avoid disrupting that balance.

And so in other states where it might take you three years and lots of lobbying to get a new judge or a new group of judges, honestly, in Delaware, when we need it, we go explain it, we figure out how to fund it, and we get it done. It's that simple.

Because if it was perceived that a regime like this was taking away from the ability of these judges to meet our public's demand for high quality jurisprudence in a very prompt fashion, that would eat into our franchise. And anything that eats into our franchise is immediately dealt with. It really is an incredibly impressive system, especially from an outsider's point of view.

AUDIENCE MEMBER: Another question. Do the chancellors have their full resources, their staff, their clerks?

GREGORY VARALLO: They do.

AUDIENCE MEMBER: They're public employees. Do they have to sign confidentiality agreements?

GREGORY VARALLO: No, they don't sign any agreements. But since the statute makes these, by definition, confidential, they would be violating the law if they weren't keeping them entirely confidential.

And these are folks who deal with the most important business issues day-in, day-out that have a huge impact on trading markets. So it's a court, including its employees, who are highly attuned to the need to be ultra-careful about confidentiality. There was a question over here?

AUDIENCE MEMBER: I was going to ask you to talk about the unique things in Delaware that make the system work. Do you think, then, that this system would not necessarily be viable in other states because they don't have that same commitment?

GREGORY VARALLO: I got a great story on this. One of my dear friends was Chairman of the California Corporation Law Revision Commission, which was the bar's—I think it was the state bar's system of trying to keep the California Corporation Code up-to-date.

So it was her job to take—sort of do what John Mark explained earlier—input from clients and lawyers and prepare a bill and bring it down to the legislature and explain to the legislature why it was necessary and why it was good for California to make this or that change.

Like I said, for more than one hundred years, when those bills go down to Dover, the state capital of Delaware, they get passed verbatim. And she called me, and we talked through some of the issues that she was dealing with because she was trying to make California in-line with Delaware on an important technical point, which long ago escaped me, but it was important at the time.

And we talked a lot about it, and she sent me the memo she was preparing for the legislature, and she was going to go give testimony and all that good stuff. About six months later, I saw her at an ABA function and said, “How did that bill go, did you ever get the bill passed?” And she said, “You know, it almost brought me to tears.” I said, “What’s wrong?” She said, “Well, it went into the legislature as planned, and we put the memo in, and somebody decided to attach a rider on it prohibiting abortions in California.” Honest-to-God truth.

Well, of course it died immediately, and that was the end of the corporation law bill. And with all due deference to the legislators and the legislatures, it is their domain to do that sort of thing if they want to do that sort of thing. What distinguishes Delaware is this unwritten understanding that the legislature is going to act in a way as partners with the bar and the bench to make sure that the product we’re selling to the rest of the world—and we are selling it to the world, it’s not just the U.S. corporate law, but it’s used around the world—is leading edge, state of the art, and designed in a way to be the most user friendly, most usable possible.

And when we stop doing that, we’re going to lose up to a quarter of our revenue, and that would be really bad. California’s revenue base is not nearly so dependent upon the ability of their corporate lawyers to do corporate law. You know, it’s uniquely a small state solution because everybody knows everybody and you get the message out and it works. Not that you couldn’t do it in a big state, but there are lots of social issues that wind up getting in the way of getting technical stuff done in many states.

AUDIENCE MEMBER: Well, in terms of arbitration from the lawyer’s perspective, I was wondering how this affects the nature of your practice in terms of the pace of the work that you have to do, the quality and volume you have to accomplish in a short amount of time and even your bottom line, your revenue stream because you’re not involved in protracted litigation.

GREGORY VARALLO: Yeah, wonderful question. One of the things that we do in Delaware as a steady diet is preliminary injunction and TRO applications to stop deals or to allow deals to go through if you're on the defense side.

And those tend to be drop everything, spend three or four weeks intensely focused on one project and only one project, and our firm is sort of built to be able to accomplish that where a couple of lawyers can just step out of everything they're doing and other lawyers step in and help run their other cases while they're off doing preliminary injunction work.

This is an expanded version of that. This is, instead of being three to four weeks, this is three to four months. And they are clearly very difficult to do because to get a whole case presented in ninety days, especially where you have to potentially travel to depositions and such—I will say the last one I did, I was in Taiwan for a week. I was in—we had Korea come to Taiwan, but we had a number of Asian depositions. And, you know, just getting from here to California and California to Asia and doing all that ate up several weeks of the ninety days, and it was exceedingly difficult to do.

On the other hand, we charge premium rates to do it. And if a client is fighting in one of these fights, they understand that while they're going to get a big bill, the bill is always, by definition, going to be smaller than if it took a year to present the same matter.

The work expands to meet the volume, right? So if you've got a year, you're going to do a year's work. And I'm not suggesting anything but entirely appropriate ethical representation. It's just that if you have a year to think about something, you tend to do more work rather than less.

If you have ninety days to prepare it, you're going to work every single one of those ninety days, seven days a week. But you can only go so many hours in ninety days, and my guess is that you will bill substantially less to the client ultimately.

So the good news is you can send out a big bill because you've got a big team working for ninety days. The bad news is it kicks the heck out of your regular practice, and you need partners to be able to cover that. And the good news for the client is that they wind up overall paying less than they would if this were a more leisurely litigation. Does that answer your question?

AUDIENCE MEMBER: Yes.

SAM FAYE: Kind of particular to the previous six arbitrations you did in the program, but was there any fear that pending the enjoinder a party who had been involved in the private arbitration proceedings

would try and have a past decision thrown out because the process itself was unconstitutional?

GREGORY VARALLO: Yes, there was such a fear. I'm not sure I'm at liberty to talk deeply about it. As it turns out, the plaintiff pointed to one of these arbitrations that was ongoing during the injunction proceedings in federal court, but I don't think he asked for retroactive opening of the record.

I think what he wanted was an opening of these proceedings on a going-forward basis on the theory that if you went forward, you would have fair warning that it was no longer private as opposed to having to take on the interests of the various companies that were arbitrating with not only the expectation, but the expectation under a validly passed statute of a sovereign state that this was, in fact, a private matter.

So I think the plaintiff—I'll give him credit as my former colleague, long since departed. But I will give him credit for making an interesting tactical decision not to try to reopen everything that had already been done.

In the next panel, when we talk about constitutionality, I'll also point out, though, that the judge issued an injunction that she wasn't asked to issue. She was asked to make this open to the public going forward rather than striking down the statute or enjoining them altogether. Nobody asked her to issue the injunction she issued, which is one of the interesting questions on appeal. Anybody else? Yes, sir.

AUDIENCE MEMBER: With all the confidentiality involved in these cases, is there any worry about the precedential effect on cases going forward? And I know a lot of corporations choose to incorporate in Delaware because it has that large volume of case law that they can rely on.

GREGORY VARALLO: You know, it's an interesting question, and there was a professor up in Boston, I think, who took the view that this was bad for Delaware because we would be limiting the amount of jurisprudence that came out of the Court of Chancery, thereby effectively undermining our franchise in the long run.

I actually was talking to the chancellor about this very point on Monday, and he's a pretty animated guy. He said, "Yeah, let me get this straight. We live or die on the quality and amount of our jurisprudence. We're going to allow that to happen, right?" And his point was we're not going to get to that point where there is no public litigation or no fair volume of public litigation.

It is true that whatever happens in these stays private and can't be cited as authority, and many of them, we simply had a bottom-line

result as opposed to an opinion explaining the result. So you wouldn't have precedent, and it was private anyway.

But I think that the thinking—and I think it's correct actually—is that there are a category of cases that make a lot of sense for this kind of alternative dispute resolution, and there are some that don't make as much sense, and then there are a whole group of cases that are never going to get here. For example, class actions by stockholders, derivative actions, contests over elections, which are effectively the bread and butter of what the Court of Chancery does. This largely is a subset of highly specialized contractual disputes. And you know, having one less contract case, okay, the law's a little bit poorer for it, but it's certainly not going to affect it overall. The judgment, I think, is it doesn't affect the overall franchise. Interesting question, though. Anyone else? We've run over a little bit. Sam, thank you very much.

