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Delaware's Closed Door Arbitration: What the Future Holds for Large Business Disputes and How It Will Affect M&A Deals

Authors

Myron T. Steele, Thomas J. Stipanowich, Robert Anderson, James R. Griffin, Katherine Blair, and Monica Shilling

**DELAWARE'S CLOSED DOOR
ARBITRATION:
WHAT THE FUTURE HOLDS FOR LARGE
BUSINESS DISPUTES
AND HOW IT WILL AFFECT M&A DEALS**

OCTOBER 30, 2012

PANELISTS*

DISTINGUISHED VISITING JURIST, CHIEF JUSTICE MYRON T. STEELE
DISTINGUISHED VISITING PRACTITIONER, JAMES R. GRIFFIN
MS. KATHERINE BLAIR
MS. MONICA SHILLING
PROFESSOR THOMAS J. STIPANOWICH
PROFESSOR ROBERT ANDERSON

* A special thanks to our panelists: Chief Justice Myron T. Steele of the Delaware Supreme Court; James R. Griffin, Partner, Weil, Gotshal & Manges, LLP; Katherine Blair, Partner, K&L Gates, LLP; Monica Shilling, Partner, Proskauer Rose, LLP; Thomas J. Stipanowich, Academic Director, Straus Institute for Dispute Resolution, William H. Webster Chair in Dispute Resolution, and Professor of Law, Pepperdine University School of Law; Robert Anderson, Associate Professor of Law, Pepperdine University School of Law

Professor Stipanowich: Today Professor Anderson and I are honored to participate in a discussion with our Distinguished Visiting Jurist, Chief Justice Myron T. Steele of the Supreme Court of Delaware, and a panel of individuals who have extensive experience representing leading corporations in litigation in the Delaware courts. We are here to discuss the Delaware Open Door Arbitration Program, an experiment that attempts to marry the expertise of Delaware's famous Court of Chancery with the concept of private binding arbitration. Only recently this program was the subject of a decision by a Pennsylvania federal district court judge, sitting by designation, in *Delaware Coalition for Open Government v. the Honorable Leo E. Strine, Jr., et al.*, which concluded that the implementing Delaware statute and Chancery Court Rules violated the qualified public right of access to trial under the First Amendment. Right now, this decision has been appealed to the Third Circuit, and I'm told, may make its way to the Supreme Court.

To begin our cutting edge discussion on this fascinating topic, I can think of no more knowledgeable individual than Chief Justice Myron Steele of the Supreme Court of Delaware.

Distinguished Visiting Jurist, Chief Justice Myron T. Steele: The genesis of the Delaware Arbitration Procedure began, as many initiatives begin in Delaware, with what we call the Corporate Council, an arm of the Delaware State Bar Association, which is made up of lawyers who practice in the corporate field, who represent in-house corporate counsel, plaintiff litigators, defense litigators, corporate counseling and corporate transaction lawyers. Their objective every year is to make sure that the Delaware corporation law is updated annually as needed and our alternative business organization statutes are updated annually to make sure no other state is keeping pace with our view of progress in the area of dispute resolution and statutory corporate governance principles in the corporate world.

All that said, this program was initiated by statute. If you read the case, you get the impression that the federal district court judge that decided it, misunderstood that fact, and believed that it may have been created by court rule. And what I'm going to do for you in just a few minutes is go through a number of the questions that are raised by the process after telling you briefly about how it's supposed to work. There have only been seven cases brought in the Court of Chancery. But they are major disputes among major corporations who are chartered in Delaware. Now the genesis of the act is simple. It's absolutely intuitive. We have 51% of the publicly traded corporations in the United States of America chartered in Delaware. We have 61% of the Fortune 500 companies chartered in Delaware. The arbitrator process is an advantage we offer to our chartered corporations or corporations whose principal place of business is in Delaware. To my knowledge, there is nobody who has a principal place of business in Delaware that isn't also chartered here. One possible exception is Astra Zeneca, which is a London, UK entity, but its American operations are principally based in Delaware and its local entity is chartered in Delaware. So this is a service we offer to our constituents, our customers, in addition to the regular court system.

The idea was that this is something that is needed, and desired by the

business community. If appropriately tailored, it would be taken advantage of by the business community as an alternative to arguably otherwise, expensive litigation for reasons you heard earlier—cost of discovery. Most importantly, the best product we think we offer is not only our code, but expedition; cases get tried very quickly in the Delaware court system. The Delaware Supreme Court and all courts in Delaware have a rule: 90 days from the time the case is submitted to a judge for a decision, he or she must render a written opinion or you get reported to me and I discipline you for failing to obey that rule. That's why all of my cases are decided in 89 days; because it's very embarrassing to discipline myself. We stick to that rule because we know that our customers, our citizens, corporate and otherwise, want cases handled expeditiously.

Secondly, we're focused on the fact that increasingly, corporate and commercial work is done at an international level—multinational corporations dealing with each other, some of whom are chartered in Delaware. When they enter into contracts with any of these not chartered in Delaware and there's a question about the reach to settle disputes among them. We wanted to offer an arbitration alternative before the members of our Court of Chancery that guarantee widely recognized competent business court judges who are familiar with the law that underlies these agreements. And it doesn't really matter whether that law is the New York Law of Finance or the Delaware law of contracts. If the parties select Delaware as the forum, we will adjudicate it, so long as at least one of those parties is chartered or has its principal place of business in Delaware. Actually, there were some of us, and I'm one of them, I confess, I didn't think it was necessary to have that particular restriction; that the dispute has to have at least one Delaware citizen or one entity with its principal place of business in Delaware. But the judgment of the General Assembly and the judgment of the Executive Branch was: people who are actually, in effect, to be colloquial, paying dues to be a Delaware citizen, are the people who should get this service, not people who don't pay the dues to be in Delaware.

So, if you're not paying a charter fee, and you're not paying taxes because your principal place of business isn't there, you wouldn't have access to this alternative. But the process does recognize that businesses want as many alternatives to dispute resolution as they can get because circumstances are never the same—day in and day out. On some occasions they may want to litigate, on other occasions they may want to mediate and on other occasions they may want to arbitrate. It all depends on the factual scenario that gives rise to the dispute. But the one thing we know they want is a competent resolution within an expeditious period of time. And they want some confidence and some predictability of outcome from the process that exists for them to use.

So, between the Delaware Bar Association, the Executive Branch, the General Assembly and the court system, we drafted a statute, one the General Assembly quickly passed that allows the Court of Chancery to implement rules that would allow arbitration in the Court of Chancery between two business entities, with a member of the Court of Chancery serving as the arbitrator. There is a filing fee of substance, a \$15,000 filing fee. The member of the Court of Chancery, unlike his European counterpart, does not get paid extra for that arbitration. You might be surprised to know that there are five countries in the world that have separate international arbitration courts and in many of the

European Union countries, sitting judges paid by the state can also sit outside that role as a private arbitrator and be paid separately—be paid a fee for conducting that arbitration. That’s not the case under the Delaware system. There’s no question of this being some kind of second source of income for judges, there is no incentive to get extra income. The only extra income judges in Delaware can ever get is from teaching or publishing a book, and actually have people read it, which would be even more amazing. But the purpose was to offer an alternative to something that did not exist, a gap-filler in dispute resolution, that we thought was innovative, and we thought would be attractive.

Now it takes a year or two for these kinds of alternatives to become known. We don’t take ads in the Wall Street Journal to advertise that this arbitration process is available to businesses. You won’t see us on CNBC, despite, I think, the clever commercials that we could do. But the word gets out through the business community. The transactional lawyers here will discuss how that can happen. I’ll leave it to them. But disputes have to arise out of the situations where parties agree to this process. So it takes time to see the volume of work that would occur. Well, our process has been interrupted by the litigation. And the litigation has focused on the horror of having judges who work in public buildings, whose salaries are paid by the public citizens, secretly resolving disputes among businesses, overlooking the obvious fact that in domestic relation cases in the family court, and many other proceedings are closed to the public for good public policy reasons. And overlooking the fact that most of what judges do, in their official capacity as judges, is not in open court. Most of the decision-making is made outside of open court. There are office conferences that aren’t conducted in open court. There are cases where trade secrets are involved and the parties agree to seal that part of the dispute even though it’s in regular, organized civil litigation. And the public policy supports that because we want ways of resolving disputes that have predictability, consistently, and clarity.

We believe in the rule of law. We don’t believe in hiring gangs of thugs to resolve disputes between businesses. We want it done in an orderly and intelligent fashion. So this was simply an alternative. And let me briefly—if I still have time—briefly go through some of the myths that surround the process; some of the issues that were raised by those who opposed having the arbitration in the Court of Chancery.

One of the claims they make is that the Chancery arbitration statute creates a secret court and that violates the spirit of courts being open to the public. Well actually, that’s clearly a myth. Everyone knows that without confidentiality, no arbitration is going to be successful, whether it’s in a court system, in a public building, with a publicly paid judge as the arbitrator, or whether it’s the American Arbitration Association doing it privately, in a suite, in the Ritz-Carlton in Los Angeles. Confidentiality is essential to getting the dispute resolved. People don’t lay out the facts that may hurt their business down the road in a public setting so their competitors can have access to information. It’s absolutely nonsensical to believe otherwise, and historically, arbitrations have always been conducted outside the public view.

Interestingly, the Federal Judicial Center says “confidentiality is generally considered a bedrock principle for most alternative dispute resolution procedures. Thus, participants in court-based ADR, are usually assured at the outset of the

process, that their communications will be kept confidential.”

Don't federal district court judges go to training at the Federal Judicial Center? I guess the answer to that is, not all the time; not in every case. And more importantly, for those of us who believe in empirical data supporting your theory, there is absolutely no evidence that if public access to Court of Chancery arbitration proceedings were mandatory, that there would be any business arbitration in the court at all. So the alternative would go away.

The next argument is, doesn't arbitration in the Court of Chancery involve a genuine court hearing? And then, if it's a court hearing, shouldn't it therefore be subject to openness to the public? Well actually, no. Arbitration in the Court of Chancery is fundamentally different than civil litigation. In civil litigation, a plaintiff can bring an unwilling defendant into court, with jurisdiction over that defendant and service of process whether the defendant wants to appear or not. The defendant risks a default judgment by failing to contest that complaint as filed against him. In arbitration, no arbitration takes place without the consent of all of the parties to the arbitration. In civil litigation, the judge's power to decide a case comes from the judicial authority inherent with the appointment, the nomination, the confirmation, and the wearing of the robe. In arbitration, it's the agreement of the parties that empowers the judge. The judge wouldn't be taking on this dispute at all otherwise. The fact is that the Vice-Chancellor in the Court of Chancery, as a public official, have no basis to resolve the dispute unless the parties agree that the judge should resolve the dispute.

In civil litigation, the parties supply the factual record to go forward and discovery is enormously time-consuming and expensive unless the court carefully tailors it, as frankly, the Court of Chancery does 99% of the time. But in contrast, in arbitration, the hearing is informal. The parties typically don't examine witnesses, formal rules of evidence don't apply, and the arbitrator, him or herself can require parties to supply information that neither of the parties had requested from the other just to help the arbitrator resolve the dispute.

When members of the Court of Chancery under this act and the rules implementing it, act as arbitrators, they're not acting as judges; there's nothing revolutionary about judges acting as arbitrators. The American Bar Association Model Code of Judicial Conduct allows arbitration by judges as part of their official duties and even to arbitrate disputes in their private capacity if their local rules allow it.

It can be considered, as is in Europe, even consistent with the public interest allowing judges to moonlight and be paid for arbitration, but that's not contemplated by the Delaware statute. Now, there's concern that arbitration in the Court of Chancery would allow the business community to demand a private audience without any public witness about how the results favor or impact them.

Well, frankly, there is no jurisdiction over cases that give rise to public interest. Business doesn't have carte blanche to bring any dispute they want into the Court of Chancery in this "secret proceeding." Public disclosure requirements still apply. If a homeowner's property is harmed by the operation of an oil and gas producer, the homeowner's claim against the producer can't be resolved using this statute. Insurance companies denying coverage under a policy can't use this process for arbitration. Cell phone companies improperly releasing personal data

about a customer, a claim of breach of privacy, can't have the dispute arbitrated under the Chancery proceeding.

All matters that have significant public importance must still be publicly disclosed. There are federal regulations about disclosures of stockholders and about the resolution of disputes between companies. So the fact that these disputes may be arbitrated in Chancery in front of a Vice-Chancellor or Chancellor doesn't negate jurisdiction over public interest litigation. It's litigation avoidance for companies that have a disagreement on a truly commercial dispute between two companies. The filings in the Court of Chancery are publicly docketed. The Court of Chancery arbitration statute treats appeals of arbitration to the Delaware Supreme Court as public, not confidential.

Now, it's not a full appeal. Appeals of an arbitration award can be based solely on corruption, or fraud and it can be voided. It's not an appeal in the sense of typical civil litigation where you determine whether or not the arbitrator correctly applied principles of law to the facts of a particular case. Now the heart of the dispute that's on-going now before the Third Circuit is whether the First Amendment of the United States Constitution guarantees public access to all action by judges who are paid by public dollars and using public facilities. Delaware's state constitution has an open courts provision, but what that means in our constitutional history is, courts are open in the sense that anyone who has a claim, the court must be open to them to file the claim. It's not a restriction on the way in which courts can handle the processing of the dispute in the court system.

Well frankly, the First Amendment has never, by the U.S. Supreme Court, been ruled to reach that far and much of what judges do now is outside public view. There's no public right of access to what judges do on mediations and settlement discussions. Those proceedings are routinely closed to the public. In order to protect proprietary business information, trade secrets I was talking about earlier, that is subject to confidential treatment. Juveniles and family members in domestic relation cases have their proceedings closed to the public. There are many instances where there isn't public access to everything that goes on in the court system and sound public policy allows rational distinctions to achieve the public good at the end of the day.

Now my personal favorite argument as a former litigator is, isn't the Delaware Chancery Arbitration Statute just a way for Delaware lawyers to make money and for the state to earn filing fees?

Well, let's put on the shelf any concern that there's a problem with lawyers making money. I think there's a problem when lawyers aren't making money; not that they are. But the statute is not designed for that purpose. The statute is designed to keep the United States, and in particular, Delaware, competitive in international business dispute resolution. It promotes Delaware's long-standing, back to 1910, interest in providing businesses fair treatment in our courts. Chancery arbitration is unique. It offers efficiencies that aren't available in other forms of arbitration: one, an extremely prompt hearing. Not too many years ago, when I was on the Court of Chancery, a case was litigated in front of me, as a Vice-Chancellor, involving the distribution during the Iraq War of predesigned medical units for our forces in Iraq. Part of that were ambulances, which were being sold out of Lebanon, manufactured by Chrysler in Europe, and then

transported to Iraq. Any dispute arising out of those agreements was to be arbitrated in London, a very competitive seat for dispute resolution in the world. They brought suit in Delaware, the United States, and related parties brought suit in Delaware, saying “reject the arbitration provision, because we can get an answer much faster from the Delaware Court of Chancery resolving this dispute on the delivery of these ambulances, than you’ll ever get from London; it’ll take us another year before we’ll get London to resolve this under this Arbitration Clause.” I said no; even though there’s a compelling public policy because the parties had chosen arbitration, it’s in the agreement. I’m a contractarian; you contract for it, you get it.

So the dispute lingered on before those ambulances got to Iraq. I’m not proud of that decision because of the arguable consequence, although I never heard of any particular consequence floating from it. But it’s an interesting point in my life because it shows that arbitration privately isn’t always a better way to resolve disputes that need to be resolved quickly. You get an arbitrator with no personal, financial interest in reaching the right outcome.

Now that’s cynical, but arbitrators are paid by the day, not necessarily by the case. They’re paid for their time they spend in the case. Delaware members of the Court of Chancery get paid the same, whether they resolve this case in 3 days or 90 days. You get an arbitrator who’s knowledgeable about the current state of the law and who’s accustomed to apply the law. It’s not a “catch as catch can” from a list that the parties pair down, hoping to get one or three to sit as arbitrators in the case.

And finally, the concern was raised that this will detract in two ways from the service that the Court of Chancery already provides. One, there will be a wave of these cases that will so overwhelm the court that the court won’t be able to expeditiously achieve the results that have typically been known to be achieved in regular business disputes through civil litigation. There’s no sign of that; no indication that that’s the case, no indication that the process would be unmanageable and if that ever occurs, Delaware would react with the resources accordingly. The important thing which is typical of Federalism—and I’ll close with this—is to seek out and experiment with alternatives to dispute resolution that will allow us to see if they will work, to see how they will operate. Other states will copy it if they work well, if the system works well. Other states will reject it if it works badly, if it doesn’t seem to be the choice of business.

The market will provide access to people for an alternative dispute resolution, and reject it if it’s unworkable, too expensive, too slow, or unmanageable in any particular way. But to destroy the opportunity in our federal system for states to explore this alternative is self-defeating as the United States attempts to compete internationally in dispute resolution of international commercial and corporate agreements as well as domestic corporate and commercial agreements. So that’s the Delaware story and I’m sticking to it!

PANEL COMMENTS

Professor Stipanowich: Again, let me thank Chief Justice Steele for that extraordinary presentation. He offered not only a very complete treatment not only of the genesis of the program, but also of the subsequent litigation. I would like to

hear from our other panelists now, all of whom represent clients that have the opportunity to take advantage of this system, to provide some reflections on that choice.

I'd now like our panelists to talk about client perceptions of the system as it developed. Can we focus, first of all, on the practicalities and client choice if the Delaware system is available.

Ms. Katherine Blair: So with regards to the client choice, as Judge Steele had pointed out, they can't advertise, they can't say, "hey, come to Delaware and do our arbitration." So as the legal community becomes more familiar with the process and more comfortable with it, it's going to trickle down because they're going to recommend it to their clients.

It is fairly new in the legal community so it's not used as much, but it has been used in agreements and I know that parties have discussed putting it in there. They have the advantages, as you said, as they have sitting judges who are *the* experts on Delaware law doing the arbitration. That is a huge draw to clients. And also the confidentiality; that was a big one too. And now that it's in limbo, obviously, folks are going to wait and see what happens before they implement it because they don't necessarily get, you know I think, the primary benefit is, the confidentiality. And that's what—you know—you can get that in any arbitration. The question is, what's wrong then if it's struck down to be used in Delaware, you guys can just go anywhere else and arbitrate it elsewhere. But you don't have the benefit of knowing who's going to be doing the arbitration, as opposed to litigators going back and forth with, "does anybody know so and so?" "Has anybody worked with so and so?" with regards to arbitrators. And it really is a draw where you actually have folks who have published opinions and you can look at and have a sense of predictability. You know—query—whether though, in the long term, with the Delaware arbitration, you know is that going to be diluted in the future?

Professor Stipanowich: Katherine, have you actually have a client that incorporated a reference to this program in a dispute resolution clause?

Ms. Katherine Blair: Yeah, a few. We've had folks—when this actually first came out—in joint venture agreements, it was used. Not necessarily in the M&A context, but in the joint venture agreements, because it was private, so it made sense for us.

Professor Stipanowich: Have the rest of you had clients that have actually embraced this system?

Mr. James Griffin: To some extent, yes. I believe the real benefit here is that, to the extent that a client wants to utilize an arbitration procedure for post-closing disputes, getting the best-qualified people to decide those disputes is critical. And in my view there is no better group of five individuals in the country that know more about how M&A deals are done, how M&A deals are structured, and what parties mean when they agree to provisions in an agreement, than the members of the Court of Chancery. So, to the extent a client wants to use arbitration as a dispute resolution procedure, then to be able to utilize the judges in Delaware to hear that dispute is a huge benefit.

As M&A counsel, your role is to negotiate and document the deal and the parties' understanding of the deal. Clients get somewhat concerned when the parties discuss arbitration as a dispute resolution mechanism, as you cannot

necessarily advise the client which arbitrator is going to decide the issues should a dispute arise in two or three years down the road. However, if you can advise them that, regardless of when the dispute arises, the dispute will be resolved by members of the Court of Chancery, that is a huge benefit, given the experience of the judges in that court.

That being said, my practice tends to be more heavily weighed to the representation of public companies in M&A transactions, and in public company transactions, when you have a strategic buying acquiring another public company, you don't typically see arbitration as a dispute mechanism, at least in my experience. I think there may have been one deal done maybe a year and a half ago that was a cross-border transaction where the foreign entity was not comfortable with our legal system and the potential for damages, and delineated that the Delaware arbitration proceeding would be used for any disputes between the parties.

In the private company context, I have seen it at least negotiated, in the initial drafts of the acquisition agreements, as well as in confidentiality agreements. But for the most part, I have not seen it end up in the final agreements as often. As the Chief Justice pointed out, it's going to take some time for parties to get used to this procedure and to see how it benefits the parties that utilize the procedure before the concept starts to make its way throughout the M&A bar.

Professor Stipanowich: Jim, can you explain why resort to this arbitration procedure might be regarded as inappropriate or unnecessary in the context of public companies?

Mr. James Griffin: Sure. Where arbitration provisions tend to be utilized is in situations where there is a post-closing dispute, perhaps over a representation or warranty that was made by the target and that was breached, and where the buyer has the right to recover damages for the breach pursuant to an indemnification provision in the agreement. As an example, the target makes a representation in the agreement that it has "complied with applicable law" with respect to its business. It turns out that, six months after the closing, there is a claim that the target violated the law, and the buyer has to come out of pocket to settle that claim. In those situations, the buyer would bring in an indemnification claim against the target or against the target's stockholders, to be compensated for that claim. These arbitration provisions would delineate the process in which those claims are resolved.

In the public company context, you don't have post-closing disputes because the focus in a public company acquisition agreement is protecting the parties between signing and closing. Why? Because the money that is paid for the target company to the target company's stockholders is paid to stockholders who have no visibility around the representations and warranties of the target company, and therefore, really haven't controlled the target company. So, in the public company arena, you generally don't have post-closing indemnification obligations, which is the area where most of the dispute resolution provisions arise.

Professor Stipanowich: Thanks for that clarification. Monica?

Ms. Monica Shilling: That doesn't mean I haven't argued in a public deal where there's a 40% stockholder that we should have an escrow and we should really get an indemnification provision, but, I don't win it all that often; though I

have won it a couple times. I wanted to step back and point out that I think we don't know how spoiled we are in having Delaware and its system available to us and what the innovation in that state has done for transactional law. When I'm doing a deal where we have some reason to use a European jurisdiction's incorporation (usually because of tax—the Netherlands come to mind), it can take two weeks to get a corporation formed that I can form in Delaware in a second. Even trying to do a closing where I have to get California good standings, you really appreciate Delaware's turn around time when you can't get them within a day in California.

So in Delaware, especially on the corporate side, you have predictability, ease of use, and flexibility, and so we all use Delaware. Twenty years ago, you didn't see people all that comfortable with LLC's because they weren't and now you see LLC's all over the place. So when I think about that, and I think about what this sort of arbitration system could do, on the litigation side, it's really disappointing that we're stuck right now. In my deals, I tend to work with financial service clients. They tend to have a confidence about their ability to win anything; so you almost never see arbitration provisions in those documents. Often times, the counter party is another financial services company, or another type of big hitter, and they're either going to settle it out—it's never going to go in front of anybody because it's going to open up industry stuff—or they're just going to go to battle; and they want everything in their arsenal, which they wouldn't have if they went to arbitration.

A caveat to that, and I think that James mentioned it, are when I have a foreign owned client. Then, it's different, and arbitration is more common. The same goes for my entertainment industry clients: they do like arbitration provisions and those are in most of their contracts. We also think about arbitration based on jurisdiction. If, for some reason, I'm in Texas or I have a significant difference in bargaining power, then I am going to look at the arbitration provisions and I probably will be more likely to negotiate for those to be in the contract. If we had the judicial arbitration available in Delaware, where you'd know generally the judges who would be arbitrating, you would have the confidence to be able to estimate the result and you actually might see arbitration moving into more of the kind of deals I do.

Mr. James Griffin: And that's an important thing too. One of the things you're going to learn, at least if you're a transactional lawyer, is in a negotiation, it's not necessarily about who always has the best arguments, it's about who has the leverage. Who has the leverage in the transaction from a bargaining perspective? I tend to represent large, publicly traded corporations, who at least in the tech-based Silicon Valley, tend to acquire smaller corporations. And some of those buyers, frankly, would prefer a litigation provision rather than an ADR provision, for the sole reason of the financial resources the public company has available to pursue any kind of indemnification claim, particularly when you couple it with a prevailing party provision that says the prevailing party in the litigation has to pay the costs, including the attorney's fees, of the losing party. If you're a target stockholder who only received \$50,000 in proceeds from the transaction, you are not likely to hire one of the litigators from our firms to pursue a large public company that has all the financial resources to litigate, knowing that, if in fact you lose, you are required to pay the litigation costs of the big public

company and the big public company's lawyers.

Ms. Monica Shilling: Which by the way, if you picked California law, which I rarely see picked in a commercial contract (other than an employment contract), that would not be enforceable. It has to be reciprocal.

Mr. James Griffin: California law is generally something you try to avoid in an M&A deal.

Ms. Monica Shilling: I get calls all the time from my New York partners. What happens in California? I don't know; I can tell you what happens in Delaware, but I have no idea as to what would happen with California as the governing law.

Mr. James Griffin: And that's an important point. You can tell what will happen in Delaware. That's one of the great benefits of that great jurisdiction.

Professor Stipanowich: Chief Justice Steele did an excellent job of addressing a number of the issues that were raised in the litigation regarding the Delaware arbitration program. Do any of you have anything to add?

Ms. Monica Shilling: I just think it's strange to stop this since it seems like a good way to compete internationally. You probably have heard this, but there is a perception, that the American litigation system is not cost-effective, is unpredictable, and that it takes a really long time, which is why you find London as one of the centers of dispute resolution. And so this seems to be good for everyone in that it gives you the predictability. Everybody's interests are aligned and it gives you a speedier way to get to the resolution; so it just seems odd to me that people are finding it problematic.

Professor Robert Anderson: And I think a big question about this so—let me sort of change this around and ask it in a little more skeptical tone is—why hadn't more companies arbitrated under this procedure? And it seems to me that this is a quintessential lawyer decision, not a client decision. I mean, if lawyers know about anything, it's about how to resolve disputes in court or outside of court, you know, much more so, than really any other provision in the agreement. So obviously, I shouldn't say obviously—but it appears, that deal lawyers were not advising clients to go this route.

Ms. Monica Shilling: It's because we don't always talk to the litigators when we do the arbitration provisions. Those are back in the miscellaneous section. You never fight about it. You're up until 3:00 in the morning. It's going to take a while.

Ms. Katherine Blair: It's the last on the list, if anything. It's a throw-in.

Ms. Monica Shilling: I would liken it to the way people are now comfortable using LLC's. When people first starting using them, a lot of people thought there's no way these work, right? There's no way you can do all this stuff with this and make it this flexible. Well, you can, but it takes a while for it to be accepted. Part of that is because one of the things you try to do is "cross the street in a crowd," so you aren't out there alone in case you are wrong. And so, it takes a while. That's what you do in law; you don't necessarily try to get the very best deal you can get for your client because if the other side doesn't have the bargaining power to do something that's market, you're just going to end up in litigation that's going to cost more later. You're practical. You try to figure out, who wants what, and get there.

Ms. Katherine Blair: And only if both parties are on board, which I think in our experience and it's maybe more of agreements, somewhat between equals if it's like a joint venture, so it's not a buyer and a seller. But they're both on the same page and are both trying to accomplish the same goal. If we happen to have a conflict, we want to be able to resolve it quickly; that's why we want to go to the Delaware Chancery Arbitration.

Ms. Monica Shilling: I think, we were all talking before, it's the industries, certain industries, I think, are going to lead it; you know, tech, pharma, and other companies where confidentiality is so important. You probably would see them leading the use of it and then others would follow.

Mr. James Griffin: In my experience at least, this is not an area of intense negotiation. There are hundreds of issues in an acquisition agreement and whether it's short-sighted or not, the dispute resolution provision with respect to what jurisdiction's law is going to govern any dispute and who hears that dispute is not, perhaps unfortunately, been a major focus of my clients at the negotiating table. Like Katherine said, clients tend to not want to waste time negotiating this when, for example, they really want to get a lower deductible in the indemnification provision.

Now, whether that's shortsighted or not, I have had clients strongly prefer to not have these issues resolved by any court. In these situations, you may negotiate for arbitration and seek to have that heard by a judge sitting in Delaware. And it gets into some sort of trade at that point in time.

Ms. Monica Shilling: And the models will be important too. I didn't look at the ABA Model to see if they had this sort of the arbitration language included, but that is one place that could lead to people being aware of it and using it in their contracts. For me, a lot of the times when there is a desire for arbitration, it's coming from a very sophisticated in-house legal department who's made decisions internally on how they want to do their contracts and so that's another thing; it probably hasn't started to get to the in-house lawyers yet.

Professor Stipanowich: This is a really important dynamic I want to reinforce for everybody regarding arbitration and conflict resolution. These topics are usually put off until the very end of the bargaining process, if they are dealt with at all. . . . What would it take for companies to recognize the potential benefit of the Delaware program and embrace it in their contracts?

Mr. James Griffin: And the Chief Justice mentioned this a couple times; predictability—that is a huge benefit in M&A deals, and that's why you see Delaware as the jurisdiction of interpretation and for hearing any dispute. I think Monica mentioned this earlier—clients are generally reluctant to innovate when it comes into a negotiation of a major acquisition. You hear the bankers talk about all the time that the deal needs to be “market,” whatever “market” means. There's a general reluctance to try something new until clients have seen the results of that process. Yes, we're comfortable with the Court of Chancery, but tell me about this arbitration. Who's done these arbitrations before? How does it work? And those are tough questions to answer if this is a point you really want to stick to in the negotiations.

Ms. Monica Shilling: Right. And what happens if everybody chooses it? How long is going to take to get to court?

Professor Robert Anderson: Well, so, I think these are all interesting questions. We've talked about the main considerations that would go into using this process. That is confidentiality and confidence in the Chancery Court, and the Vice-Chancellor's judgment, right?

So, one might ask why you can't get consensus between the two parties about that. You say to the two parties at the bargaining table, "hey, do you like confidentiality?" "Oh yes, yes, we need confidentiality." "How about good judgment among a decision maker?" "Yes, that would be valuable as well." "Why don't we agree?" Why don't the two deal lawyers innovate—I realize that the reason it's not being incorporated is because it's part of the boilerplate at the end of the document and you just, you use the precedent from the last deal, and you don't want to mark that part up.

My own experience from marking up documents was that the markups would trail off quite a lot from the beginning of the document towards the end. By the end, there was just periods being corrected or whatever. But, you know, so why wouldn't the other party agree to this? Everybody wants confidentiality and certainty and predictability and why wouldn't the other deal lawyer agree to this and why is it even a client issue? You probably don't discuss the governing law with the client.

Ms. Monica Shilling: Oh yeah, sure we do. Absolutely. We spend a lot of time on that.

Professor Robert Anderson: But the client's not going to know the difference and whether New York Law –

Ms. Monica Shilling: But we do and we can tell them. I mean, some of it is, do you think you can crush the other side with paper and having more money? And so, if you do, then a lot of times, clients don't want to go to arbitration. The second thing is you don't know how it's going to fall out. If everybody said no more JAMS, no more AAA, we're going to Delaware Chancery Court, how do you know you can even get on the schedule? If everybody did that, because you haven't seen the process, you don't know how it's going to work.

Professor Robert Anderson: Well, he'll discipline them.

Ms. Monica Shilling: Well, not knowing how it's going to work scares people off. They want to know how it's going to work. I think it would eventually catch on just like LLC's did—I keep going back to that example, it's the only one I can think of. Actually, arbitration itself is another good example. I was a summer at Skadden in 1994, which tells you how old I am. I remember a research assignment where I was looking to see if an arbitration provision was enforceable to a resolve a particular kind of issue in a contract. You know, we take it for granted that people can do this, and they can contract for this. But times have changed dramatically over the last 2030 years in terms of what you can do with arbitration and what you can't do and that's part of this whole idea; it's being innovative and trying to make these things work. Now this case will be one more reason; let's say it gets overturned. This case will be one more reason for somebody to say, "oh, I don't know if that's really going to work."

Mr. James Griffin: You also have to understand the process in which this arises. At least in my practice, the buyer's counsel tends to produce the first draft of the acquisition agreement. As you would expect, a buyer is going to draft a

document from a way most advantageous to the buyer. Then, the seller's counsel takes it and they mark it up and you come back with provisions that reflect the seller's position.

Ms. Monica Shilling: Well, first you complain and say that it's so, so far from market that they need to. . . .

Mr. James Griffin: But after those first two rounds of exchanges, you come up with an "issues list" that identifies the material issues in the deal. That issues list, depending on the buyer's and seller's counsel, can be anywhere from two pages to four or five pages and you'll have anywhere from ten to fifty material issues that need to be resolved. This discussion about governing law or who's going to hear the case in a dispute generally does not survive that first issues list, because there are so many other major aspects of the negotiation that are more material and that the clients will want resolved among the lawyers very quickly. If you argued over everything for an extended period of time, you'd never get a deal done.

Ms. Monica Shilling: And if you're on a public company clock, you have to realize the backdrop of these deals. Secrecy is incredibly important. Usually, only the very, very top people know what is happening because you're worried about the market finding out. Oftentimes, you will negotiate the entire contract over a weekend. As technology continues to improve and the distribution of information moves so quickly—All of our lives, everything—It almost feels like the market cycles have contracted, because everything moves so fast. On a public deal, it's probably not going to come up anyway because you're not going to have post-closing liabilities. On a private deal, I think you're going to see leadership from in-house counsels really be the catalyst to demand this in documents because they're the ones that have to deal with the fallout later anyway. They're the ones that have to manage the process.

Ms. Katherine Blair: And it's going to depend on the circumstances. You know, like for us, the bankers. I represent a lot of companies, and so, you know, kind of the saying is "it's the golden rule." Whoever has the gold rules. And they'll come in and for example, with all the investment bankers, it's New York law.

Mr. James Griffin: It's always New York law.

Ms. Katherine Blair: It's New York law. And we don't even touch that; that's a waste of my clients' money to even talk about it at that point. I envision, honestly, that it would catch on when you start seeing organizations like the ABA actually propose a draft arbitration provision and attorneys and law firms will distribute it and start saying "here's an alternative," so that attorneys can then pop it in. And they can just tell a client, "hey, new thing, you know, we can do arbitration. And since we're talking about arbitration anyway, and you're in Delaware, we can do the Delaware Chancery Court." That's when I see it catching on.

Ms. Monica Shilling: It may be the thing that moves people who don't have the pre-negotiated arbitration clauses now to use them. It may actually move those people saying, "Well, if I knew I could arbitrate in front of the Chancery Court, then, you know, I'll try it."

Professor Stipanowich: Assuming the current Delaware arbitration program

is not upheld, are there other realistic alternatives that might offer some or all of the same benefits?

Ms. Katherine Blair: Well, the closest you could get to that is instead of using sitting judges you use judges who are no longer sitting, but Delaware judges, so that you have the knowledge that it's somebody who has expertise in that field, but then you don't have what is the perceived maybe conflict or something that's truly seen as private.

Professor Stipanowich: Right. And that's certainly a common model today. And in fact, in California, we have a rent-a-judge system, where you have a privatized form of litigation that's established by statute. You have former judges that are sitting and everything is confidential; in other respects, it looks just like litigation. Mr. Chief Justice Steele, do you have thoughts about that?

Chief Justice Myron T. Steele: Well, my immediate, maybe it's visceral, but my immediate reaction to what you just said about California by comparison is when our judges leave the bench, they go back to private practice and make substantially more money than they made as judges and they are competing, they have clients that create conflicts for them. There isn't really any ready body of former judges available to serve as arbitrators even though they may well have the past experience of being a member of the Court of Chancery or the Delaware Supreme Court—three members of the Delaware Supreme Court, formerly the members of the Court of Chancery. We don't have the volume of people that we could offer that as an alternative. I think it would be difficult to combine, as you were talking about earlier, the advantage of Delaware and that expertise with a private arbitration system. It would be—It's not impossible, but it would be very difficult. And not that, I think, attractive to the judges who are now partners at Paul Weiss, Wilson Sonsini, Weil Gotshal, and all over the place, making a few dollars more than they made when they were public servants. They're not really interested in serving as \$3,000 per day arbitrators.

Professor Robert Anderson: One of the big issues, I think, I'm not sure that the district court judge here really realized the gravity of the question that was being decided, because really in a sense, the question that was being decided is "what is a court?" And "is this a court?" And I'm not sure that the 23-page opinion did justice to that fairly large question of what is it that makes a court a court and what are the aspects that could be tweaked so that this could—You could imagine a situation, I'm sure, where the Chancery like this where they were paid extra, I suppose. Would that make a difference in the constitutionality of it? Because then it would be outside their regular judicial duties—the problem can't be that they're using court facilities because court facilities are used all the time for these types of arbitration. So, you know, it's kind of trying to tease out what the different dimensions are. Is it just the fact that you have all of these things that are individually okay, but when you combine them together, you're a court and therefore, you need to have public access to it? And I don't know whether anyone on the panel has a reaction.

Chief Justice Myron T. Steele: I have a reaction to that. I don't think the focus—And sadly, I wasn't able to participate in the litigation—wasn't part of it fundamentally, but more like sort of an outsider looking in, other than as a defendant, of course. That part doesn't appeal to me. But, it was one of the

modern gods to which we all pray is transparency. And this court was focused on transparency above all things. And the fear, that there would be something shady going on in the background, and a special option for businesses, that wasn't available for "the ordinary citizen," closed with that somehow nefarious conduct would take place behind closed doors. That drove it more than any kind of, I think, rational analysis, of what is the appropriate function of the court.

Among the notes I have, as long ago as 1908, the United States Supreme Court recognized in *Prentis v. Atlantic Coast Line Justice Holmes*, that the U.S. Constitution allows each state to decide what powers to confer on its courts. A state court can be vested with non-judicial powers. That's a United States Supreme Court opinion 100 years old that establishes that principle. And this was an option offered to some people to resolve their dispute differently than others and it barred any dispute in which there would be a genuine public interest for being handled that way.

So, while I think it's focused on transparency and how fashionable it would be to craft an opinion that the newspapers and media would praise, and it would embellish the view that the courts are open in the transparency sense, instead of the availability sense, it was a fashionable opinion. It wasn't an opinion that focused on the broader picture, which is our ability to compete successfully with international dispute resolution entities outside this country. As we see more and more business focused, international business focused, outside of the United States, to the extent of inside focus.

Professor Robert Anderson: And, excellent example of that, that is near and dear to my own heart is admiralty, where there used to be a lot of cases in U.S. Federal Court; now they're all offshore. They're all arbitration in London, or Hong Kong, or Tokyo. There are hardly any U.S. court cases anymore about cargo disasters and so forth because it's a specialized body of law, where they want confidentiality and they can't get what they want from the federal court system in the United States. So they go offshore in arbitration and so, you know, this is in some way an attempt to recapture this. You know, just like business disputes, most judges don't know that much about admiralty disputes; and it's the same type of problem that they want certainty and predictability, so they're going to take it somewhere else. So it's a way of recapturing the American court system, I guess, or an attempt to.

Professor Stipanowich: Would the Delaware arbitration alternative be something you would entrust with novel questions of law?

Ms. Monica Shilling: For my clients, it's still going to go back to bargaining power. It's still going to go back to "can we crush them?" Or, are we really worried we are going to lose, and we want to get into a different format—I'm going back to my critical legal study days. But it's not a search for truth; it's "who is going to win?" So, I guess, it just depends.

Ms. Katherine Blair: So are you saying though, that if a novel, legal issue arises, as a result of the action that's going to take place in the Delaware Chancery Arbitration, is that what you're asking, is that something the clients would take into account and say "gosh, because of that, we think we want to go into the public court system and create precedence or. . ."

Professor Stipanowich: I'm really asking, first of all, would the present

Delaware system, where you have judges, sitting judges, actually making a final determination, would that be satisfactory as an alternative to going to court?

Ms. Katherine Blair: The argument that I guess I would make in keeping it in arbitration is that yeah, this is a novel issue of law and it can always be appealed because you agree that it would be appealed to record, if that really happens.

Mr. James Griffin: Assuming it's just a pure business M&A dispute, and not some specialized issue—such as in BioPharma—and both parties want arbitration, I as an M&A practitioner, am not only entirely comfortable, but I would be an advocate to having that proceeding being heard by members of the Court of Chancery. That's because these five judges are well-versed in M&A law and terminology and understand how these transactions get done. The members of the Court of Chancery understand why buyers seek certain things and sellers seek certain things and why certainty of contract is so important in a business transaction. If I have a client who wants arbitration, I'd be entirely comfortable going to the Court of Chancery.

Ms. Monica Shilling: And I think, if you fast forward five years and you could see based on experience that you could get through it quicker, you know it's going to be cheaper, and you know you're going to get to the right outcome, then you'll see a bunch of people adopting it. I represent underwriters a lot and they are not fans of things of first impression. They're not going to want to know what the arbitrator thinks or what a judge thinks on important industry matters, no matter what it is. If it's something that they're not going to want to lose, there are some things in that industry, in that financial services industry where your reputation is a lot of what you're doing. They're just going to get worked out on the side and it's never going to see a judge or an arbitrator.

Mr. James Griffin: You're not going to see underwriting agreements, large credit facility agreements, large financial transaction type agreements, and capital markets agreements governed by anything other than New York law.

Ms. Monica Shilling: It's relatively recent, that you see the big PE funds trying to pull something like a MAC out. For years, you wouldn't see anybody trying to do that because it affected their reputation as a counter party and it affected who the sellers wanted to sell to. The bargaining power/leverage changed a little bit. Different people have tried it and different things have happened. So it's fluid and it would change, but I think, again, you'd want the history. And once you saw the history, then you'd see more people go into it.

Professor Stipanowich: Another thing I find fascinating about this system is that it's actually rendering transparent some of the costs of the court system. There's been a growing discussion about the fact that certain users of the court system use it disproportionately, and questions about whether or not there should be some additional levy against frequent users. Here, in essence, you have a glimmer of that. You're saying, let's charge them an administrative fee and also charge for the judge sitting on the case. Is that a positive thing?

Ms. Monica Shilling: For my clients, that seems like a bargain.

Professor Stipanowich: I know that's not even an issue in the kinds of cases we're talking about here—this particular cost. But from the standpoint of a taxpayer, it is at least, on some level, a contribution to the actual cost of court. Maybe it should be higher?

Chief Justice Myron T. Steele: I take your point. State government, anyway in my state, there's always a debate over the fairness of a user tax, or a user fee. You go across the bridge and you're expected to pay a toll. People who don't cross the bridge don't pay a toll. What's wrong with that? If you want this arbitration process, it's limited to disputes of \$1 million or more; it's limited to disputes between people who are parties to a commercial or corporate contract, not limited to M&A by any means, although that's been the focus of discussion here—and it's only in cases where there are monetary damages.

So a fee of \$15,000 in that context, they're taking a judge away from other work the judge can be doing. It's a very modest cost; but it's one that helps other people who want access to that court system from the court system. The ordinary Delaware consumer citizen isn't complaining about this at all because it's an influx of money to fund the court system that wouldn't otherwise be there and they don't have to pay through their taxes.

Professor Stipanowich: Sounds like you could charge a good deal more.

Ms. Monica Shilling: I think you could.

Professor Stipanowich: I mean this is a premium service.

Chief Justice Myron T. Steele: Well, you test the market and see how it works.

Ms. Monica Shilling: Just to add to what you said—Do I think there's a benefit to the state by getting the revenue that comes in? Of course, but I think the bigger benefit is keeping Delaware competitive, keeping the U.S. competitive. So while the money is nice and everything, I think it's dwarfed by the bigger issue.

Chief Justice Myron T. Steele: Interestingly, the way it was sold to the General Assembly was the benefit that Delaware doesn't come from a \$15,000 user fee. The benefit to Delaware comes from this is genuinely attractive and the limitation on being able to have access to this alternative is you charter in Delaware. The charter fee could be \$150,000 per year. So, that's where the money comes in. Some people could argue vigorously that we have a \$3 billion budget in Delaware, and almost a third of that comes from the court system. We don't see any of the backups . . . About 33%37% of the budget, arguably, is focused on the court system and law related filings of other kinds.

Professor Stipanowich: This brings to mind a phenomenon we are seeing in some emerging regional centers for commercial arbitration around the world, in order to bring instant credibility, some new programs are bringing senior retired judges from Great Britain and elsewhere to serve as arbitrators in their commercial arbitration tribunals. The United States is facing extraordinary and unprecedented competition as a forum for resolution of commercial disputes.

Professor Robert Anderson: One other question I wanted to raise, because we were talking about it before the session, to see what people's reactions to it is, there's the potential question of whether as these—if this arbitration procedure did catch on, the idea that all this precedence that would otherwise be out there in Delaware, about cutting edge issues in mergers and acquisitions and other areas of law, now will be private, does that in any way cut into the value that Delaware has as the premier corporate law jurisdiction when the other lawyers aren't able to observe those valuable precedence in predicting behavior anymore and it becomes entirely reliant than on the quality of the Vice-Chancellor's as individuals to

resolve your disputes sensibly.

Ms. Monica Shilling: You can already do that. People can already privately contract; you can already take that away. I'm not sure it's going to change the analysis that people go through when they decide arbitration or not, which has a lot more to do with bargaining power than anything else. I suspect that if there's interaction with this corporate counsel, then you would see legislation to deal with gray issues and deal with things that could be resolved by statute.

Mr. James Griffin: And, I do think you've got to remember the context in which these disputes arise is where you've got post-closing indemnification – where you've got a dispute among two commercial businesses surrounding a claim for breach.

The case law in Delaware, the case law on fiduciary duties of the Boards of Directors—those types of cases tend to arise in a public company acquisition context. Not always—but a good portion of the major case law from Delaware involves the acquisition of a public company where the plaintiff alleges that the target board breached its fiduciary duties. And so you have public disclosure around that. Interpretation of contractual provisions in business disputes—there is some case law on that from the Delaware courts. But I don't think with the Delaware arbitration procedure there's a real risk that there's going to be some sort of hidden jurisprudence that buyers and sellers aren't going to be able to get visibility on.