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Third Circuit Panel Strikes Down Court of Chancery's Confidential Arbitrations

Posted by Noam Noked, co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Friday November 8, 2013

Editor's Note: The following post comes to us from Frederick H. Alexander, Chair of the Executive Committee and partner in the Delaware Corporate Law Counseling Group at Morris, Nichols, Arsht & Tunnell LLP. The following post is based on a Morris Nichols publication by Mark Hurd and John DiTomo. This post is part of the Delaware law series, which is cosponsored by the Forum and Corporation Service Company; links to other posts in the series are available here.

A three-judge panel of the U.S. Court of Appeals for the Third Circuit—issuing three opinions, a majority, concurrence, and dissent—today [Oct. 23, 2013] affirmed a district court ruling enjoining the Delaware Court of Chancery's arbitration program. Click here to download a copy of the Court's opinion.

In 2009, the Delaware General Assembly enacted legislation empowering sitting judges of the Court of Chancery to arbitrate private business disputes so long as one party is a Delaware entity, neither party is a consumer, and the amount in controversy exceeds $1 million ("Chancery Arbitrations"). Like most private arbitrations, Chancery Arbitrations are conducted confidentially. In 2011, the Delaware Coalition for Open Government challenged the constitutionality of Chancery Arbitrations, arguing that because the proceedings are conducted in private, the program violated the First and Fourteenth Amendments of the U.S. Constitution, which guarantee a right of public access to certain government proceedings. In 2012, the district court enjoined the members of the Court of Chancery from conducting Chancery Arbitrations, concluding that the proceedings were no different than civil trials to which a right of public access extended. The Chancellor and Vice Chancellors appealed the decision.

The Split Decision

Writing for the majority of the panel, Judge Sloviter began her analysis with reference to the experience and logic test. Under the experience and logic test, a proceeding invokes a right of public access when: (1) "there has been a tradition of accessibility" to that kind of proceeding, and

(2) “access plays a significant positive role in the functioning of the particular process in question.”

In regard to the experience prong of the test, Judge Sloviter held that “the history of civil trials and arbitrations demonstrates a strong tradition of openness for proceedings like Delaware’s government-sponsored arbitrations.” Thus, “[w]hen we properly account for the type of proceeding that Delaware has instituted—a binding arbitration before a judge that takes place in a courtroom—the history of openness is comparable to” other proceedings that have been found to include the right of access. For the logic prong of the test, Judge Sloviter held that “[t]he benefits of openness weigh strongly in favor of granting access to Delaware’s arbitration proceedings.” Thus, because experience and logic supported openness to Chancery Arbitrations, conducting such arbitrations in private violated the public’s right of access.

Judge Fuentes concurred, but noted that the “crux of today’s holding is that the proceedings … violate the First Amendment because they are conducted outside the public view, not because of any problem otherwise inherent in a Judge-run arbitration scheme.” Judge Fuentes’s concurrence concludes that Chancery Arbitrations would pass constitutional muster if Rules 97(a)(4) and 98(b) (the rules establishing the confidential nature of the proceedings) were “excised from the law.”

In her dissent, Judge Roth stated that Chancery Arbitrations create “a perfect model for commercial arbitration,” and she did “not agree with Judge Fuentes’s contention that the Delaware Court of Chancery’s arbitration proceedings cannot be confidential.” Judge Roth also challenged Judge Sloviter’s conclusion that “the history of arbitration … reveals a mixed record of openness.” Rather, Judge Roth observed that, “historically, arbitration has been private and confidential.” Finally, Judge Roth concluded that “the resolution of complex business disputes, involving sensitive financial information, trade secrets, and technological developments, needs to be confidential so that the parties do not suffer the ill effects of this information being set out for the public—and especially competitors—to misappropriate.” Accordingly, Judge Roth would have reversed “the judgment of the District Court and [upheld] the statute and rules which establish the Delaware arbitration system.”