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The U.S. Court of Appeals for the Third Circuit Strikes Down Delaware's Confidential Arbitration Program

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On October 23, 2013, a three-judge panel of the U.S. Court of Appeals for the Third Circuit—issuing three opinions—a majority, concurrence, and dissent—affirmed a District Court ruling enjoining the Delaware Court of Chancery's arbitration program. In 2009, the Delaware General Assembly enacted legislation empowering sitting judges of the Court of Chancery to arbitrate private business disputes (Chancery Arbitrations). Delaware's decision to offer businesses a forum for arbitrations was meant to promote the state's goals of (1) addressing businesses' increasing demand for alternatives to civil litigation as a means of resolving commercial disputes, and (2) making the state's expert judiciary available to satisfy that demand with well-reasoned results and savings of time and expense.[1] To qualify for a Chancery Arbitration, at least one party had to be a Delaware entity, no party could be a consumer, and the dispute had to involve an amount-in-controversy of at least one million dollars. Like most private arbitrations, Chancery Arbitrations were intended to remain confidential. The proceeding would only become public if a party sought judicial review of the arbitrator's determination.

The Complaint and Response

On October 25, 2011, the Delaware Coalition for Open Government (Coalition), filed a complaint under 42 U.S.C. § 1983, naming as defendants the State of Delaware, the Delaware Court of Chancery and the Court's five current members. The case was filed in the Federal District Court for the District of Delaware, but was reassigned to Judge Mary A. McLaughlin of the Eastern District of Pennsylvania. The Coalition alleged that because Chancery Arbitrations were conducted in private, the program violated the First and Fourteenth Amendments of the U.S. Constitution, which guarantee a qualified right of public access to certain government proceedings. The defendants answered the complaint, and the parties both moved for judgment on the pleadings.

Defendants argued no right of public access existed under the "experience and logic" test, which was adopted by the United States Supreme Court in *Press–Enter. Co. v. Superior Court*.[2] Under the experience and logic test, a government proceeding carries a right of public access

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if (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 that particular process. Defendants argued that the history of openness with respect to arbitrations was most relevant. In that regard, Defendants highlighted that Chancery Arbitrations were different than civil trials in key respects; most notably, the proceedings are conducted with the parties' consent, not under the auspices of coercive state power; the procedures are flexible, subject to the parties' design; and the arbitration decision lacks precedential value, subject only to limited review. Because Chancery Arbitrations were like other forms of private arbitration, and because arbitrations historically were closed to the public, experience shows that there was no history of openness. As a matter of logic, defendants argued that Chancery Arbitrations fulfill an important societal function, but if they were open to the public, the program would fall into disuse thereby defeating the fundamental rationale of arbitration.

The Coalition argued that Chancery Arbitrations were simply a bench trial under a different name. More specifically, the arbitrator is a sitting judge acting pursuant to power granted by the State (and not merely by private contract); the arbitration fee is paid into a court; the proceedings take place in a courthouse on government time (and government salary); the proceedings are conducted pursuant to court rules, under which the arbitrator functions as a judge; and the arbitral award is effective and enforceable without bringing a legal action to confirm it. Citing *Publicker Indus., Inc. v. Cohen*,[3] in which the Third Circuit extended the right of access to civil trials, the Coalition argued that because a Chancery Arbitration was no different than a civil trial, Chancery Arbitrations should be open to the public.

The District Court Decision

On August 20, 2012, Judge McLaughlin issued an opinion holding that a right of access extended to Chancery Arbitrations and that "the portions of [10 *Del. C.* § 349] and Chancery Court Rules 96, 97, and 98, which make the proceeding confidential, violate that right."[4] In so holding, Judge McLaughlin asked a threshold question: "Has Delaware implemented a form of commercial arbitration to which the Court must apply the logic and experience test, or has it created a procedure 'sufficiently like a trial' such that *Publicker Industries* governs?"[5] In answering that question, the District Court observed that Chancery Arbitrations are conducted by "a sitting judge of the Chancery Court, acting pursuant to state authority," in which the judge "hears evidence, finds facts, and issues an enforceable order dictating the obligations of the parties."[6] In contrast, the District Court observed, "[a]rbitration differs from litigation because it occurs outside of the judicial process. The arbitrator is not a judicial official."[7] In addition, the District Court was troubled by the fact that Chancery Arbitrations were conducted by sitting judges because a judge bears "a special responsibility to serve the public interest,"[8] "judges in this country do not take on the role of arbitrators"[9] and "the public role of that job[] is undermined when a judge acts as an arbitrator bound only by the parties' agreement."[10] The District Court concluded that it was unnecessary "to reiterate the thorough analysis of the experience and logic test performed by the Court of Appeals in *Publicker Industries*."[11] Rather, because Chancery Arbitrations function "essentially as a non-jury trial before a Chancery Court judge"[12] a qualified right of access existed.

The Third Circuit Decision

The District Court's decision was appealed, and the case was assigned to a three-judge panel of the U.S. Court of Appeals for the Third Circuit. On October 23, 2013, the Court of Appeals affirmed the District Court's holding 2 to 1.[13] Writing for the majority, Judge Sloviter rejected the District Court's decision to forego the experience and logic test, noting that "[a]lthough Delaware's arbitration proceeding shares a

number of features with a civil trial, the two are not so identical"[14] that it was appropriate for the District Court to forego the experience and logic test. The Court also rejected the parties' "either/or" approach, concluding that "an exploration of both civil trials and arbitrations is appropriate."[15]

Under the experience prong of the test, Judge Sloviter first focused on the history of openness for civil trials, recounting the analysis undertaken in *Publicker Industries*. Going back as far as 1267, the Court tracked the history of public access to civil trials and reaffirmed that "civil trials and the court filings associated with them generally are open to the public"[16] because "[t]he courthouse, courtroom, and trial remain essential to the way the public conceives of and interacts with the judicial system."[17]

Turning to arbitrations, Judge Sloviter observed "a mixed record of openness."[18] Again citing examples dating back to the 13th century, Judge Sloviter observed that "although proceedings labeled arbitrations have sometimes been accessible to the public, they have often been closed, especially in the twentieth century."[19] Judge Sloviter noted that confidentiality was a "natural outgrowth of the status of arbitrations as private alternatives to government-sponsored proceedings."[20]

In contrast, "proceedings in front of judges in courthouses have been presumptively open to the public for centuries."[21] Based on those observations, Judge Sloviter concluded that "history teaches us not that all arbitrations must be closed, but that arbitrations with non-state action in private venues tend to be closed to the public."[22] "Understood in this way, the closure of private arbitrations is only of questionable relevance."[23] Judge Sloviter then observed that "[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.[24] Thus, for both civil trials, as well as arbitrations, history demonstrated "a strong tradition of openness for proceedings like Delaware's government-sponsored arbitrations."[25]

Applying logic, Judge Sloviter determined that allowing public access to state-sponsored arbitrations would serve the public's interest in a number of respects: (1) giving "stockholders and the public a better understanding of how Delaware resolves major business disputes";[26] (2) allaying "the public's concerns about a process only accessible to litigants in business disputes who are able to afford the expense of arbitration";[27] (3) exposing "litigants, lawyers, and the Chancery Court judge alike to scrutiny from peers and the press";[28] and (4) "discouraging perjury and ensur[ing] that companies could not misrepresent their activities to competitors and the public."[29]

The Court then determined that there would be little if any corresponding harm to the public's interest if Chancery Arbitrations were conducted openly. First, confidentiality concerns that arise in litigation could be addressed through application of the Court of Chancery's existing rules, and that the risk of "loss of prestige or goodwill," though perhaps unpleasant, was not a sufficient enough interest to trump the public's right of access.[30] Judge Sloviter similarly rejected the argument that privacy fostered a less hostile, more conciliatory approach to dispute resolution, noting that private arbitrations are often still contentious and any collegiately was just as likely to be attributable to the procedural flexibility of the arbitration as it was to the privacy of the proceeding.[31] Finally, the Court rejected the argument that opening Chancery Arbitrations to the public would end the program. In that regard, Judge Sloviter was skeptical that confidentiality was the sole advantage of Chancery Arbitrations. Rather, "disputants might still opt for arbitration if they would like access to Chancery Court judges in a proceeding that can be faster and more flexible than regular Chancery Court

trials."[32] Thus, having considered both the positive role that access plays, and the extent to which openness impairs the public good, Judge Sloviter concluded that "[t]he benefits of openness weigh strongly in favor of granting access to Delaware's arbitration proceedings."[33]

In a short opinion, Judge Fuentes concurred with Judge Sloviter's analysis but wrote separately to make clear his view that the "crux of [the] 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."[34] Judge Fuentes also took occasion to note 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."[35] The defendants had made a more limited severance argument, indicating that the Court could uphold the statute and rules implementing Chancery Arbitrations if Rule 98(f)(3) was excised. That provision enabled the arbitrator to confirm the arbitration award without a separate court proceeding, and arguably was the only aspect of the program that invoked the coercive power of the state. Judge Fuentes rejected the argument noting that "the mere formality of filing that award in Court, which Rule 98(f)(3) skirts, does not alone alter the First Amendment right of access calculus one way or another," and therefore severance "would not be enough to cure any constitutional infirmity."[36] Judge Fuentes concluded with the observation that "it is likely that the Delaware Legislature has at its disposal several alternatives should it wish to continue to pursue a scheme of Judge-run arbitrations."[37]

In her dissent, Judge Roth acknowledged Delaware's legitimate interest in preventing the diversion elsewhere of complex business and corporate cases and stated that Chancery Arbitrations create "a perfect model for commercial arbitration."[38] Judge Roth expressed her view that Judge Sloviter appeared to misapprehend "the difference between adjudication and arbitration, *i.e.*, that a judge in a judicial proceeding derives her authority from the coercive power of the state while a judge serving as an arbitrator derives her authority from the consent of the parties."[39] Judge Roth also challenged the majority's conclusion that the history of arbitration reveals a mixed record of openness. Instead, an examination of confidentiality in arbitration should not extend back to medieval times but should begin in colonial times.[40] There, "[t]he tradition of arbitration in England and the American colonies reveals a focus on privacy."[41] Thus, as a rule "arbitration has not 'historically been open to the press and the general public'";[42] rather, experience shows that, "historically, arbitration has been private and confidential."[43]

Finally, Judge Roth observed that logically "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."[44] Judge Roth acknowledged that Delaware's initiative was meant "to provide arbitration in Delaware to businesses that consented to arbitration—and that would go elsewhere if Delaware did not offer arbitration before experienced arbitrators in a confidential setting."[45] Accordingly, Judge Roth would have reversed "the judgment of the District Court and [upheld] the statute and rules which establish the Delaware arbitration system."[46]

Conclusion

The opinions issued in this case could be read as a debate about whether sitting judges should act as private arbitrators. Indeed, the District Court's decision stood on the view that judges should not arbitrate private disputes. Judge Sloviter's opinion, albeit not directly, echoed that concern, for despite a centuries-old history of arbitrations being conducted in private, that

history was only of questionable relevance to Judge Sloviter because Delaware's arbitration program involved proceedings in front of judges conducted in courthouses. The concurrence and dissent disagreed. Judge Fuentes stressed his view that there was nothing wrong with sitting Judges of the Court of Chancery engaging in arbitrations, and his opinion left room for an alternative confidential arbitration scheme sufficiently devoid of the air of an official State-run proceeding. Judge Roth would have upheld Delaware's arbitration program as currently implemented, noting that other countries have already begun to adopt government-sponsored arbitration programs having acknowledged the importance of arbitration to their economies and to their position in today's world of global commerce. In all events, it remains to be seen whether there will be a further appeal. But, the decision to strike down Delaware's arbitration program is a significant setback to Delaware's creative attempt to enter the ADR market, leveraging its well-developed business law and expert judiciary through a program that addressed its businesses citizens' increasing demand for private ADR services, both in the United States and internationally.

Notes

1. Del. H.R. 49, syn.
2. 478 U.S. 1, 10, 106 S. Ct. 2735, 92 L. Ed. 2d 1 (1986).
3. 733 F.2d 1059 (3d Cir. 1984).
4. Delaware Coalition for Open Government v. Honorable Leo E. Strine, Jr., *et al.*, 894 F. Supp. 2d 493, 504 (D. Del. 2012).
5. *Id.* at 500.
6. *Id.* at 503.
7. *Id.* at 501.
8. *Id.* at 501.
9. *Id.* at 502.
10. *Id.*
11. *Id.* at 503-504.
12. *Id.* at 494.
13. Delaware Coalition for Open Government v. Honorable Leo E. Strine, Jr., et al., C.A. No. 12–3859 (3d Cir. Oct. 23, 2013).
14. *Id.* at 10.
15. *Id.* at 12.
16. *Id.* at 13.
17. *Id.*
18. *Id.* at 16.
19. *Id.* at 16.
20. *Id.*
21. *Id.* at 17.
22. *Id.*
23. *Id.* at 17n.2.
24. *Id.* at 17.
25. *Id.*
26. *Id.* at 19.
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.* at 19-20.
31. *Id.* at 20.
32. *Id.* at 21.
33. *Id.* at 19.
34. *Delaware Coalition for Open Government v. Honorable Leo E. Strine, Jr., et al.*, C.A. No. 12–3859 (3d Cir. Oct. 23, 2013) at 3 (Fuentes, J. concurring).
35. *Id.*
36. *Id.* at 5.
37. *Id.*
38. *Delaware Coalition for Open Government v. Honorable Leo E. Strine, Jr., et al.*, C.A. No. 12–3859 (3d Cir. Oct. 23, 2013) at 4 (Roth, J. dissenting).
39. *Id.* at 4n.2.
40. *Id.* at 6.
41. *Id.*
42. *Id.* at 7.
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.* at 8.