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Arbitration in the Delaware Court of Chancery

New Delaware Chancery Court rules provide an expeditious and private alternative to public litigation. They allow for virtually unlimited contractual flexibility to the parties to design their alternative dispute resolution mechanism.

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On January 5, 2010, the Court of Chancery adopted new rules providing for Chancery arbitration pursuant to a Delaware statute permitting Delaware's Chancery judges to act as private arbitrators.[1] At the highest level, the new alternate dispute resolution (ADR) regime created by these rules allows for consensual, prompt, nonpublic arbitration of disputes before a sitting Chancery judge. The regime also contemplates virtually unlimited contractual flexibility to the parties to design their ADR, including the ability to waive appeals. While any regime built upon consent of the parties often takes some time to implement, as corporate planners contract for the new ADR platform and as disputes mature over time, the new Delaware regime is meeting with acceptance on a highly accelerated basis. To date, at least two publicly filed merger agreements have adopted a Chancery arbitration provision for dispute resolution with several others in various stages of negotiation.[2] And, recently, a Court of Chancery case was dismissed and then re-filed as the first actual Chancery arbitration.[3]

Chancery Arbitration Statutes and Rules

The recently adopted Chancery arbitration statutes and rules allow parties to combine the benefits of Chancery litigation with private and expedited arbitration. The most desirable aspects of Chancery arbitration include: (1) the appointment of a sitting Chancery judge as arbitrator; (2) complete confidentiality; (3) expeditious 90 day disposition; (4) waiveable, single-step appeal to the Supreme Court; and (5) the flexibility to "customize" the process with the predictability flowing from use of the rules of evidence and rules of procedure normally associated with Chancery litigation as a fallback.

The Court of Chancery is well known for its unique competence in business litigation. The Court also is becoming a forum of choice for businesses seeking alternative dispute resolution. For some time, the Court of Chancery Rules have provided for voluntary mediation of an action pending in the Court of Chancery,[4] and for mediation of business and technology disputes where there is no pre-existing pending action.[5] The Court has

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now upped the ante by adopting rules providing for the binding arbitration of business disputes.[6]

The arbitration statute, 10 *Del. C.* § 349, provides that "[t]he Court of Chancery shall have the power to arbitrate business disputes when the parties request a member of the Court of Chancery." The statute provides a list of eligibility criteria for business disputes to qualify under Section 349: (1) all parties must consent to arbitration; (2) at least one party must be a business entity; (3) at least one party must be formed in Delaware or maintain its principal place of business in Delaware; (4) neither party may be a consumer; and (5) if the claim is solely for monetary damages, the amount in controversy must be no less than $1 million.

Upon receipt of a petition for arbitration, the Chancellor has the power to appoint either a Vice Chancellor, the Chancellor, or a Master sitting permanently in the Court of Chancery as the arbitrator of the business dispute.[7] Now former Chancellor Chandler stated publicly that requests that appointment of a particular member of the Court as an arbitrator in a given case, while not encouraged, likely could be honored if such requests are well-reasoned.

The rules governing a Chancery arbitration proceeding showcase what the Court of Chancery is most famous for—expedition and flexibility. For example, the arbitration hearing generally will occur within 90 days of the filing of the arbitration petition, which means that parties will see results fast.[8] In addition, the parties may change any of the existing Chancery arbitration rules or adopt additional ones with the consent of the arbitrator.[9] Thus, the timing and substance of the events leading up to the arbitration hearing largely will be up to the parties and the arbitrator.

The Court of Chancery's discovery rules (Rules 26 through 37)[10] apply to the arbitration proceedings unless inconsistent with the arbitration rules or the parties or the arbitrator choose to modify them.[11] Just as one example, given the typical 90-day timeframe between the filing of the petition and the arbitration hearing, parties are likely to modify the 30-day response times for discovery responses under the existing rules.[12] In addition, any sensitive, proprietary business information will be protected in these proceedings because the record of the arbitration proceeding is completely confidential.[13]

In sum, the advantages of a Court of Chancery arbitration are that Delaware business entities have a swift mechanism for resolution of a business dispute by an arbitrator experienced in such matters, the parties can work together with the arbitrator to craft rules that best suit the particular business dispute, and the record of the arbitration proceedings is confidential. Perhaps most importantly to many businesses, one can safely predict that, generally speaking, arbitrations will be less expensive than Chancery trials, given the 90-day time limitation and the likely truncation of discovery.

The First Movers and How They Did It

On December 21, 2010, Teradata Corp. became the first public company to file a public document committing the signatories to Chancery arbitration.[14] Pursuant to Section 9.07 of the merger agreement between Teradata Corp. and TDC Merger Sub, all claims against the escrow amount that equal or exceed $1 million must be submitted for arbitration in the Court of Chancery. The parties excluded from Chancery arbitration however, other claims arising under the contract, for example, specific performance claims,[15] tax claims,[16] and other highly litigable issues.

On March 3, 2011, Global Defense Technology & Systems, Inc. (Global Defense) became the first public company to file a public document submitting "any and all disputes arising under or related in any way to this Agreement or [ ] Transaction" to arbitration in the Court of Chancery.[17]

As the first full blown public Chancery arbitration provision, Section 9.11 of the Global Defense & Sentinel Acq. Corp. (Sentinel) merger agreement (the Global Defense Agreement) deserves some analysis.

Such analysis necessarily begins with the decision made by the parties to arbitrate "any and all disputes arising under or related in any way to this [ ] agreement." This is an important step toward realizing the full efficiency of Chancery arbitration. Several cases argued in the Court of Chancery in recent years illustrate that parties are often forced to litigate substantive arbitrability (whether the dispute at issue falls under the arbitration agreement) prior to being able to enjoy the benefits of prompt and private arbitration.[18] In this vein, and "[f]or the sake of clarity," the drafters of the Global Defense Agreement enumerated the legal repercussions flowing from the expansive nature of the arbitration provision:

> the parties hereto agree [1] that they are waiving and relinquishing the right to bring any dispute arising under or related in any way to this [merger] before a court of any state of the United States; [2] that they are waiving any right to have such dispute decided by a jury; and [3] that they are also waiving any right to argue that the forum for the arbitration is an inconvenient one.

And, importantly, the provision explicitly provided that "any issue concerning the extent to which any dispute is subject to arbitration shall be decided by the arbitrator."[19] Signatories and practitioners are well advised to follow suit and preempt substantive arbitrability issues by adopting explicit language regarding the scope of the arbitration provision in order to avoid the wasteful pre-arbitration litigation that can undermine the efficiency and expediency of Chancery arbitration.

Second, the Global Defense Agreement explicitly provided that "the arbitration shall be presided over by one arbitrator who shall be a chancellor or vice-chancellor of the Delaware Court of Chancery." At first glance, this statement appears to be redundant to Rule 96 which provides: "'arbitrator' means a judge or master sitting permanently in the Court." But, 10 *Del. C.* § 347 specifically requires the parties to "request [ ] to have a member of the Court of Chancery . . . act as a[n] [arbitrator] to assist the parties in reaching a mutually satisfactory resolution of their dispute."[20] Similarly, pursuant to § 349, the Court of Chancery gains its "power to arbitrate" only when the parties "request a member of the Court of Chancery . . . to arbitrate a dispute."

Parties are often forced to litigate substantive arbitrability (whether the dispute at issue falls under the arbitration agreement) prior to being able to enjoy the benefits of prompt and private arbitration.

Third, the Global Defense parties agreed that the arbitrator would "have the authority to grant any equitable or legal remedies that would be available in any judicial proceeding to resolve a dispute, including entering injunctive or other equitable relief," including specific performance. Arguably, this provision is not necessary since, unlike non-judicial arbitrators, the Court of Chancery judges presumably would consider themselves capable of granting injunctive relief without the need for that power to be enumerated in the parties' agreement; indeed, the rules even contemplate such a result.[21] On the other hand, if parties to an arbitration agreement were to rely on the fact that Delaware statutes authorize judges of the Court of Chancery to issue equitable remedies in order to justify the assumption that the Chancery arbitrator has power to act

equitably, that party would—by the same logic—be constrained by the limitations imposed on the judges in the Court of Chancery. In this regard, the statute provides that "[t]he Court of Chancery shall not have jurisdiction to determine any matter wherein sufficient remedy may be had by common law, or statute, before any other court or jurisdiction of this State."[22] Accordingly, it may be more important for parties to agree that the Chancery arbitrator shall have authority to grant legal remedies, rather than authority to grant equitable remedies. The Global Defense arbitration provision provided for both. Thus, for now, it may be most prudent for parties to explicitly state the extent of authority the arbitrator will have in regard to equitable *and* legal remedies.

Finally, the Global Defense Agreement provided that "all awards of the arbitrator shall be final, nonappealable, and binding on the parties." The decision by the parties to opt out of the single-level appeal to the Supreme Court ensured (1) faster final resolution and (2) continued strict confidentiality. Obviously, while opting out of a potential appeal provides expediency, a party that is unsure whether it will prevail on the merits of the case may prefer a longer process that includes an appeal backstop. Also, in regard to confidentiality, as stated previously, had the Global Defense Agreement permitted an appeal of the arbitration to the Delaware Supreme Court, such a provision would have undermined the privacy enjoyed in the arbitration by exposing the record to the public on appeal—as is contemplated by Court of Chancery Rule 97.[23]

Opting for Chancery Arbitration After the Commencement of Chancery Litigation

A recent case filed, and subsequently dismissed, in the Court of Chancery illustrates that private arbitration is available to parties even after litigation has commenced. On December 14, 2010, Chrysalis Ventures L.P. (Chrysalis) filed suit against Mobile Armor, Inc. (Mobile Armor) along with several of its board members and investors.[24] According to the publicly filed complaint, Chrysalis alleged that the defendants colluded to carry out a pay-to-play recapitalization that allegedly diluted Chrysalis' equity stake and allegedly resulted in a windfall to Defendants when the company was acquired by a third party—allegations vehemently contested by Mobile Armor.[25] On March 29, 2011, Chrysalis and Mobile Armor filed a Notice of Stipulated Dismissal of their Chancery litigation, without prejudice, which made clear that the case was being dismissed pursuant to the parties' executed Agreement to Arbitrate in Chancery.[26] While the parties jointly opted out of Chancery litigation, they expressly preserved for Chancery arbitration all discovery requests, subpoenas, and other discovery documents that had been served in the litigation.

While the *Chrysalis v. Mobile Armor* arbitration agreement, petition for arbitration, and supporting filings remain confidential, the genesis and trajectory of the dispute are instructive. Chancery arbitration is always available to qualifying parties that desire private and expeditious resolution of their disputes, even after the dispute has commenced as public litigation. Notably, the same judge that presided over the parties' public Chancery litigation was assigned to the parties' private Chancery arbitration. This case illustrates that the path to private and expeditious Chancery arbitration need not be confined to parties who anticipate the benefits of arbitration at the outset of their relationship; rather, parties can seek to negotiate a stipulated dismissal in favor of arbitration on a case-by-case basis.

Conclusion

Now that Chancery arbitration has been authorized as an alternative method of ADR and has been adopted by public companies in publicly filed merger agreements, and the first such arbitration is proceeding through the Court, it is likely that corporate practitioners will become increasingly aware of this alternative to expensive public litigation. It is anticipated that practitioners will

choose to rely on this alternative to shield clients from prolonged, public litigation exposure in favor of finely crafted, private ADR in Chancery. It is difficult to overstate the benefits of prompt and private disposition of disputes in the corporate and M&A context, where, for example, public disputes regarding whether or not a material adverse event (MAE) had occurred could damage both the target and the would-be acquiror.[27] In such a case, the privacy of Chancery arbitration would benefit both parties.[28] Additionally, the recent uptick in charter based mandatory forum selection clauses[29] may provide some impetus for an analogous surge in intra-corporate arbitration provisions; after all, as noted by the United States Supreme Court: "an agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum selection clause that posits not only the situs of the suit but also the procedure to be used in resolving the dispute."[30]

Notes

1. 10 *Del. C.* § 349 (adopted Apr. 2, 2009); *see* Ct. Ch. R. 96–98 (adopted Jan. 5, 2010).

2. Taradata Corp., Agreement and Plan of Merger, 8K (Dec. 21, 2010); Global Defense Technology & Systems, Inc., Agreement and Plan of Merger, 8K (March 3, 2011).

3. Notice of Stipulated Dismissal, *Chrysallis Ventures III LP v. Mobile Armor, Inc.,* C.A. No. 6069-VCL, (Del. Ch. Mar. 29, 2011), Transaction 36727167.

4. Ct. Ch. R. 174.

5. *Id.* 93-95.

6. The Chancery Court Arbitration Rules were recommended to the Court by the Chancery Court Rules Committee, which is comprised of experienced Chancery litigators from a number of Delaware law firms.

7. Ct. Ch. R. 97(b) ("Upon receipt of a petition, the Chancellor will appoint an Arbitrator"); *id.* 96(d)(2) (defining "Arbitrator" as "a judge or master sitting permanently in the Court").

8. Ct. Ch. R. 97(e). Now former Chancellor Chandler has noted that some of the benefits of Delaware alternative dispute resolution are that it is "often faster than expedited proceedings [in Chancery]" and that it offers "[r]apid deal-closing resolution with arbitration." PowerPoint: Hon. William B. Chandler, III, *Mediation & Arbitration in the Delaware Court of Chancery* at the Delaware State Bar Association CLE: "Alternative Dispute Resolution Procedures and Any Upcoming Rule Changes in the Court of Chancery: A Discussion and Q&A Session with Chancellor Chandler" (Dec. 4, 2009) (copy on file with authors).

9. Ct. Ch. R. 96(c).

10. These discovery rules provide for discovery through depositions, oral examination, written questions, written interrogatories, production of documents and all other discovery regarding matters that are relevant to the subject matter involved in the arbitration.

11. Ct. Ch. R. 96(c).

12. *See, e.g.*, *id.* 33(b)(3) (interrogatories); *id.* 34(b) (document requests). These discovery rules even allow for 45-day response times from the date of service of the summons and complaint upon a defending party, further highlighting the likelihood that these particular rules will be modified by parties engaged in Chancery arbitration. *See* Ct. Ch. R. 33(b)(3); *id.* 34(b).

13. Ct. Ch. R. 97(a)(4); *id.* 98(b).

14. Taradata Corp., Agreement and Plan of Merger, 8K (Dec. 21, 2010).

15. *Id.* at § 11.12 (Specific Enforcement).

16. *Id*. at § 10.03 (Contest Provisions).

17. Global Defense Technology & Systems, Inc., Agreement and Plan of Merger, 8K (March 3, 2011).

18. *GTSI Corp. v. Eyak Tech., LLC*, 10 A.3d 1116, 1119 (Del. Ch. 2010) (finding that "[b]y stating that the members 'shall' arbitrate 'any dispute . . . including the validity, scope, and enforceability of these arbitration provisions,' the Arbitration Provision clearly and unmistakably assigns to the arbitrator the task of determining substantive arbitrability"); *Aquila of Del., Inc. v. Wilmington Trust, Co.*, 2011 WL 1487060, at *1 (Del. Super. Apr. 19, 2011) (finding that a contract requiring "all claims" be arbitrated was broad enough to require that substantive arbitrability be decided by an arbitrator where "claims" was defined broadly in the agreement); *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 81 (Del. 2006) (requiring that "something other than the incorporation of the AAA rules would be needed to establish that the parties intended to submit arbitrability questions to an arbitrator"); *Nutzz.com, LLC v. Vertrue Inc.*, 2006 WL 2220971, at *6 (Del. Ch. July 25, 2006) (finding that a carve-out providing for alternative forms of litigation undermined a broadly drafted arbitration clause that required all disputes be decided by an arbitrator).

19. Global Defense Technology & Systems, Inc., Agreement and Plan of Merger, 8K (March 3, 2011).

20. 10 *Del. C.* §§ 347, 349 (Section 349 requires that "[f]or a dispute to be eligible for arbitration under this section, the eligibility criteria set forth in § 347(a) and (b) of this title must be satisfied").

21. Ct. Ch. R. 98(f)(1) ("The Arbitrator may grant any remedy or relief that the Arbitrator deems just and equitable and within the scope of any applicable agreement of the parties.").

22. 10 *Del. C.* § 342. *But c.f.* 10 *Del. C.* § 347 (implying that, in arbitration and mediation, the legislature intended to broaden the scope of

the Court of Chancery's jurisdiction by providing the requirement that disputes "involving solely a claim for monetary damages" must exceed or equal $1 million).

23. Ct. Ch. R. 97.

24. *Chrysalis Ventures III LP v. Mobile Armor, Inc.*, C.A. No. 6069-VCL (filed Dec. 14, 2010).

25. *Id.*

26. Notice of Stipulated Dismissal, *Chrysallis Ventures III LP v. Mobile Armor, Inc.,* C.A. No. 6069-VCL, (Del. Ch. Mar. 29, 2011), Transaction 36727167.

27. Obviously, this statement is subject to certain caveats—applicable to various defendants and plaintiffs on a case-by-case basis (*e.g.*, a party that is unlikely to prevail on the merits of its case may opt for prolonged litigation in order to wear-out its opponent; a party seeking to force settlement may prefer the increased pressure inherent in public litigation; a party seeking a large damages figure may believe that a public airing of its grievances is part of the justice it deserves).

28. *E.g., Hexion Specialty Chems., Inc. v. Hunstman Corp.*, 965 A.2d 715, 722 (Del. Ch. 2008) (requiring the buyer to specifically perform in a merger agreement despite "substantial obstacles to closing the transaction," some of which "appear to result from the course of action the buyer and its parent have pursued," including allegations of material adverse event and future insolvency).

29. *Scherk v. Alberto-Culver Co*., 417 U.S. 506 (1974); *Galaviz v. Berg*, 2011 WL 135215 (N.D. Cal. Jan. 3, 2011) (declining to give credence to a forum selection clause in a director adopted bylaw, but implying that a shareholder adopted bylaw or charter amendment may receive more favorable treatment);

30. Joseph A. Grundfest, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches*, Pilleggi Lecture, (Oct. 6, 2010) (finding that since the *Revlon* decision, there has been a sharp increase in the adoption of intra-corporate forum selection provisions among public companies; specifically, approximately twenty-three of such provisions adopted among public companies were introduced in 2010).