Securities Regulation Daily Wrap Up, ARBITRATION—3d Cir.: Delaware Chancery Court must open state-sponsored arbitrations to the public, (Oct. 23, 2013)

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By Lene Powell, J.D.

A three-judge panel of the Third Circuit found that the public has a right of access under the First Amendment to Delaware's state-sponsored arbitrations, because there has been a tradition of accessibility to similar proceedings and access plays an important role in the proceedings. Judge Jane Roth dissented from the decision, saying there is a long history of closure in arbitration proceedings, and the resolution of complex business disputes needs to be confidential so parties don't suffer from sensitive information being set out for the public — and competitors (*Del. Coalition for Open Gov't v. Strine*, October 23, 2013, Sloviter, D.).

Background. In 2009, the Delaware Court of Chancery created an arbitration process as a cost-effective alternative to trial for certain kinds of disputes. To qualify for arbitration, at least one party must be a "business entity formed or organized" under Delaware law, and neither party can be a "consumer." The process is limited to monetary disputes involving an amount-in-controversy of at least one million dollars. Both parties have a right to appeal the resulting order to the Delaware Supreme Court, but that review uses the deferential standard given in the Federal Arbitration Act. Therefore, arbitrations can only be vacated in relatively rare circumstances, such as when a party can prove that the "award was procured by corruption, fraud, or undue means" or that the arbitrator was guilty of misconduct.

The statute and rules governing Delaware's proceedings bar public access. Arbitration petitions are confidential and are not included as part of the public docketing system. Attendance at the proceeding is limited to parties and their representatives, and all "materials and communications" produced during the arbitration are protected from disclosure in judicial or administrative proceedings. The arbitrator's final award is not made public, although a conforming judgment is entered.

The Delaware Coalition for Open Government sued the Delaware Court of Chancery, individual chancellors, and the State of Delaware, arguing that the public's right of access under the First Amendment was violated by the confidentiality requirements of the law and implementing rules. In a judgment on the pleadings, the Delaware District Court ruled in favor of the Coalition, finding that the arbitrations were essentially civil trials that must be open to the public. On appeal, the defendants disputed the similarities and contended that the First Amendment does not mandate a right of public access to the arbitration proceedings.

Experience and logic standard. In a *de novo* review, the panel applied the "experience and logic" test of *Press II*. Under that standard, a proceeding qualifies for the First Amendment right of public access when "there has been a tradition of accessibility" to that kind of proceeding, and when "access plays a significant positive role in the functioning of the particular process in question." In order to qualify for public access, both experience and logic must counsel in favor of opening the proceeding to the public.

The court observed that the analysis must go beyond the mere label given the proceeding. Uncritical acceptance of state definitions of proceedings would allow governments to prevent the public from accessing a proceeding simply by renaming it, whereas defining the proceeding as a trial at the outset would elide the differences between arbitration and trial proceedings and beg the question at issue.

History of open access. The court explored the history of both civil trials and arbitrations. First, the court said that civil trials have a long history of open access, and remain essential to the way the public conceives of and interacts with the judicial system. In contrast, arbitrations have a "mixed record of openness," and many modern arbitration programs are "distinctly private." Closure could be explained by the private nature of most arbitrations, and confidentiality was a natural outgrowth of the status of arbitrations as private alternatives to government-sponsored proceedings.

The court determined that although Delaware's government-sponsored arbitrations do share some characteristics with private arbitrations, like informality, flexibility, and limited review, they differ fundamentally from other arbitrations because they are conducted before active judges in a courthouse, they result in a binding order of the Chancery Court, and they allow only a limited right of appeal. Considered in this light, the court said that its experience inquiry favored granting public access because both the "place and process" of Delaware's proceeding "have historically been open to the press and general public."

Public access plays positive role. On the "logic" prong of the test, the court said that opening the arbitration proceedings would offer a number of benefits, including giving stockholders and the public a better understanding of how Delaware resolves major business disputes. Opening the proceedings would also allay the public's concerns about a process only accessible to litigants in business disputes who are able to afford the expense of arbitration. Public access would also expose litigants, lawyers, and the Chancery Court judges to scrutiny from peers and the press. Finally, public access would discourage perjury and ensure that companies could not misrepresent their activities to competitors and the public.

Opening the proceedings would have only slight drawbacks, said the court. Confidential information such as patented information, trade secrets, and other closely held information is already protected by a rule providing for confidential filing of documents. As to Delaware's argument that confidentiality was necessary to prevent "loss of prestige and goodwill," the court said that although that might be unpleasant for the parties involved, it would not hinder the functioning of the proceeding or impair the public good. The court also rejected the argument that privacy encourages a "less hostile, more conciliatory" approach, observing that even private binding arbitrations can be contentious.

Concurrence. Judge Julio Fuentes concurred in the decision, but said it was necessary to be more specific in pointing out which sections of the statute or Chancery Court rules were unconstitutional. He said that Section 349(b) of the Delaware Code violated the First Amendment right of public access and could not stand, but other provisions of the statute were not problematic. Similarly, he found that two Chancery Court rules violated the First Amendment, but did not find any problem with the rest. The problem was not with judge-run arbitrations, said Judge Fuentes, but with the confidentiality requirement.

Dissent. Judge Jane Roth dissented from the decision, saying that judicial proceedings in the Court of Chancery are more formal, time-consuming, and expensive than arbitration proceedings. Without the current arbitration system, the Court of Chancery might not be able to compete with new arbitration systems being set up in other states and countries, and businesses may go elsewhere, she said.

Applying the experience and logic test, Judge Roth said that confidential arbitrations have been a tradition in England and America since colonial times, and as a rule, arbitration has not historically been open to the press and the general public. Logically, the resolution of complex business disputes, involving sensitive financial information, trade secrets, and technological developments, needs to be confidential so parties do not suffer the ill effects of this information being set out for the public — and especially competitors — to misappropriate.

The case is No. 12-3859.

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