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Judge-Arbitrators in Delaware

Christopher Drahozal (The University of Kansas School of Law) · Tuesday, December 20th, 2011 · Institute for Transnational Arbitration (ITA), Academic Council

It is not unusual for retired judges to serve as arbitrators. But what about sitting judges? A number of European countries permit sitting judges to serve as arbitrators. See Gary B. Born, International Commercial Arbitration 1449 (2009); see, e.g., U.K. Arbitration Act 1996, § 93. In the United States, however, ethics rules generally prohibit judges from serving as arbitrators. See ABA Model Code of Judicial Conduct, Rule 3.9.

In 2009, Delaware became an exception to this general rule when it authorized judges from the Court of Chancery — the highest profile court in the United States specializing in business matters — "to arbitrate business disputes" when the parties so agree. 10 Del. Code § 349(a). To be eligible for Court of Chancery arbitration, the dispute must meet the following requirements: (1) the parties must agree or stipulate to arbitrate; (2) at least one party must be a "business entity"; (3) at least one party must be a business entity organized under Delaware law or having its principal place of business in Delaware; (4) no party can be a consumer; and (5) for disputes involving solely money damages, the amount in controversy must be at least $1 million. Id. § 349(a) (incorporating id. § 347(a)). In early 2010, the Court of Chancery promulgated rules governing the process and issued a standing order setting out the applicable fees ($12,000, plus $6000 for each hearing day after the first, divided equally between the parties).

The Delaware judge-arbitrator process has been in the news recently with the announcement (in disclosures under the federal securities laws) of Court of Chancery arbitrations filed by Advanced Analogic Technologies Inc. and Skyworks Solutions, Inc. arising out of a merger agreement. They ultimately settled their dispute, with the merger closing albeit on modified terms. (My understanding is that at least four additional Court of Chancery arbitrations have been filed or are pending.)

But since news of the AATI-Skyworks arbitrations became public, Court of Chancery arbitration has been subjected to numerous criticisms, all of which stem from the confidential nature of the process. See 10 Del. Code § 349(b) (providing that Court of Chancery arbitration "shall be considered confidential"). Commentators have complained that the confidential nature of the process harms investors (by reducing the information available about the dispute), other businesses (by reducing the amount of precedent on Delaware corporate law), and the public as a whole (by reducing the public accountability of the court system). Indeed, on October 25, 2011, the Delaware Coalition for Open Government filed suit in Delaware federal court seeking to enjoin Court of Chancery arbitration on the ground that it unconstitutionally deprives the public of its right of

access to trials. Oral argument on dispositive motions in the case is scheduled for February 9, 2012.

In addition to important constitutional issues, Court of Chancery arbitration also raises interesting issues of arbitration law. For example, one possible benefit to parties from using Court of Chancery arbitration is that the resulting awards might be more readily enforceable overseas than Delaware court judgments. According to one commentator: "[F]or parties in disputes with foreign entities, the new statutes and arbitration rules may provide greater comfort that the arbitration award will be enforceable against a foreign entity on its home turf under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards." Lewis H. Lazarus, Court of Chancery Arbitration Likely to Become More Prevalent, Delaware Business Litigation Report (Sept. 28, 2011); see also Simpson Thatcher, Delaware Court of Chancery Arbitration Provides Option for Delaware Parties to Resolve Disputes with Foreign Counterparties 3 (Sept. 14, 2010).

For that benefit to be available, however, Court of Chancery arbitration must constitute "arbitration" within the meaning of the New York Convention. Certainly Delaware law labels the process "arbitration," and it has many of the trappings of commercial arbitration. It is consensual and confidential. The judge-arbitrator is a specialist (rather than a generalist). And the award is final and binding, and subject only to limited court review. (Indeed, Delaware law provides that the Delaware Supreme Court has the authority to "vacate … an order" issued in a Court of Chancery arbitration, and that it shall exercise that authority "in conformity with the Federal Arbitration Act, and such general principles of law and equity as are not inconsistent with that Act." 10 Del. Code § 349(c).)

But most if not all of these characteristics also are present when the parties consent to a bench trial in the Delaware Court of Chancery by means of a forum selection clause. That process, too, is consensual, and the decisionmaker is the same. The parties can waive the right to appeal, id § 351, and they likely can obtain some degree of confidentiality by consenting to the entry of a protective order. Of course, the extent of confidentiality in a contracted-for bench trial likely is less than in a Court of Chancery arbitration. Moreover, the award in a Court of Chancery arbitration, like a commercial arbitration award, needs to be enforced (i.e., turned into a court judgment) before creditors' remedies can be used to collect on it. See id. (providing that the Delaware Supreme Court has the authority to "enforce an order of the Court of Chancery issued in an arbitration proceeding under this section").

Conversely, Court of Chancery arbitration differs from commercial arbitration in at least one important respect. Unlike commercial arbitration, in which the parties pay the arbitrators (and any arbitration institution) a fee that typically varies with the amount sought, in Court of Chancery arbitration the parties pay only a filing fee to the court. The parties do not pay the judge-arbitrators; instead, the judge-arbitrators continue to be paid their usual salary by the state. (In this respect, Delaware law is like the UK Arbitration Act, under which fees for judge-arbitrators are likewise paid to the court. Tech. & Constr. Court Guide ¶ 18.2.3 (Oct. 2010).

Does the differing source of payment make the New York Convention inapplicable to Court of Chancery arbitration? The limited American case law comes solely from jurisdictions in which judges are not permitted to act as arbitrators. Thus, the Seventh Circuit has held that a process in which a sitting judge acted as an arbitrator was more properly characterized as "an abbreviated judicial procedure rather than an unauthorized arbitral one." DDI Seamless Cylinder Int'l, Inc. v. General Fire Extinguisher Corp., 14 F.3d 1163, 1165 (7th Cir. 1994) (Posner, J.) (adding that

"[f]ederal statutes authorizing arbitration, such as 9 U.S.C. §§ 1 et seq. …, do not appear to authorize or envisage the appointment of judges or magistrate judges as arbitrators"). The California court of appeals similarly has stated:

> May a sitting superior court judge conduct a private arbitration subject to confirmation under the California Arbitration Act? The answer clearly is no. Notwithstanding the parties' characterization, the "arbitration" was nothing more than a bench trial, where the judge acted in his capacity as a judicial officer. There is nothing to be confirmed except this bedrock principle: Public judges must engage in public judging.

Heenan v. Sobati, 117 Cal. Rptr. 2d 532, 533 (Cal. App. 2002); see also Elliott & Ten Eyck P'ship v. City of Long Beach, 67 Cal. Rptr. 2d 140 (Cal. App. 1997). In those cases, however, the applicable law did not authorize the judge to serve as an arbitrator.

By comparison, Delaware law expressly authorizes Court of Chancery judges to serve as arbitrators. If Court of Chancery arbitration survives constitutional challenge, it remains to be seen whether courts will find that awards resulting from the process can be enforced under the New York Convention.

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