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ARBITRATION AND THE FUTURE OF DELAWARE'S CORPORATE LAW FRANCHISE

*Brian JM Quinn**

I. INTRODUCTION

On September 9, 2011, Skyworks Solutions, Inc. (“Skyworks”) and Advanced Analogic Technologies Incorporation (“AATI”) entered into a merger agreement.¹ The agreement included an uncommon provision with respect to dispute resolution. In part, that provision stated, “the parties hereto agree that any and all disputes arising under or related in any way to this Agreement or the Transactions shall be resolved solely in arbitration before the Court of Chancery of the State of Delaware.”² Until AATI later sought specific performance of the merger agreement via arbitration pursuant to that provision, little notice had been paid by outside observers to the possible implications of arbitration before the Delaware Chancery Court.³

In early 2010, the Chancery Court in Delaware adopted rules implementing a new statutory arbitration procedure.⁴ This procedure is unique in that it employs sitting chancellors as arbitrators in confidential proceedings before the Delaware Chancery Court. The Chancery arbitration procedure, which is presently subject to a citizens’ challenge, raises questions about the propriety of using *public* courts for *confidential* proceedings, as well as the potential negative impact of confidential Chancery arbitration proceedings on the continuing value of Delaware’s corporate law franchise.⁵ It

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¹ Skyworks Solutions, Inc., FORM S-4 (Sept. 9, 2011).

² Section 9.11, Agreement and Plan of Merger, by and among Skyworks Solutions, Inc. and Advanced Analogic Technologies Inc., Annex A, FORM S-4 (Sept. 9, 2011).

³ See Skyworks Solutions, Inc., FORM 8-K (Sept. 26, 2011).

⁴ DEL. CH. R. 96-98 (2010).

⁵ See Del. Coal. for Open Gov't v. Strine, 2012 WL 3744718 (D. Del. Aug. 30, 2012).

also raises larger questions about the appropriateness of confidential arbitration in the context of shareholder litigation.

By now, the dynamics of state competition for incorporations have been thoroughly analyzed. Professors William Cary and Judge Ralph Winter debated whether state competition for incorporations resembled more of a “race to the bottom” or a “race to the top,” with respect to corporate governance.⁶ Later studies by Professors Marcel Kahan and Ehud Kamar, and also Robert Daines, concluded that, at least in recent years, the notion of interstate competition for incorporations is largely a myth.⁷ Rather, to the extent there is competition with respect to the corporate law, it is not for incorporations so much as it is for corporate governance. In that sphere, Professors Mark Roe and Renee Jones have noted the salient competition for Delaware is the federal government, which is engaged in a push-pull relationship with Delaware over corporate governance matters.⁸

Delaware’s adoption of its new arbitration procedure hints at another dimension for competition with respect to corporate law: the competition for adjudications.⁹ Competition for adjudications occurs on at least two levels. First, there is the issue of multi-forum litigation.¹⁰ Acquisitions are now regularly accompanied by lawsuits. Plaintiffs bring competing lawsuits, often worth only their settlement value, in the state of incorporation and another state where a court might have jurisdiction. Courts find themselves

⁶ William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 666 (1973) (on the “race to the bottom”). See generally Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977) (on the “race to the top”).

⁷ See generally Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559 (2002); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002).

⁸ See generally Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625 (2004); Mark Roe, *Delaware’s Competition* 117 HARV. L. REV. 588 (2003).

⁹ See Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061 (1999) (describing the value added by the judicial lawmaking of Delaware courts).

¹⁰ See John Armour, Bernard Black, & Brian Cheffins, *Delaware’s Balancing Act*, 87 IND. L. REV. 1345 (2012); Matthew Cain & Steven Davidoff, *A Great Game: The Dynamics of State Competition and Litigation* (Apr. 1, 2012), available at <http://ssrn.com/abstract=1984758>; Daines, *supra* note 7; Joseph Grundfest, *The History and Evolution Of Intra-Corporate Forum Selection Clauses: An Empirical Analysis*, 37 DEL. J. CORP. L. 334 (2012); Brian JM Quinn, *Shareholder Litigation, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137 (2011); Randall Thomas & Robert Thompson, *A Theory of Representative Shareholder Suits and its Application to Multi-Jurisdictional Litigation*, 106 NW. U. L. REV. 1753 (2012).

playing an uncomfortable role as mediator in the battle amongst the plaintiff bar over the appropriate forum, control of the litigation, and, finally, settlement. Elsewhere I have suggested a self-help approach to mitigating the worst excesses of the multi-forum litigation problem.¹¹

A second locus of competition for adjudications stems from the growing popularity of commercial arbitration. Since the passage of the Federal Arbitration Act (“FAA”) in 1925, there has been an increasing interest in private arbitration.¹² This has been encouraged, in part, by the Supreme Court’s stated “strong presumption in favor of arbitration” where contracting parties opt for private ordering over public adjudication.¹³ At the same time, private arbitration presents a competitive dilemma for our common law system of public adjudication.¹⁴ To the extent parties opt for more informal dispute resolution systems, like arbitration, they may reduce the network value of Delaware’s franchise by reducing the marginal production of legal rules by the courts. In the same way the movement to private adjudication has limited the development of the common law in other areas, a shift over time from the public courts to private systems of adjudication may present a more potent threat to Delaware’s franchise than to that of any other state.¹⁵

Adjudications play important dual roles. First, adjudications permit parties to resolve their individual disputes. Efficient dispute resolution for the parties is an important service—one that can compel parties to seek one forum over another. Second, adjudications in the formal legal system generate rules that third parties can rely on in similar fact situations.¹⁶ The positive network exter-

¹¹ See Quinn, *supra* note 10 (proposing a possible self-help solution to the problem of multi-forum transaction-related litigation).

¹² Federal Arbitration Act (FAA), 9 U.S.C. §§ 1–14 (1925).

¹³ See, e.g., *Great Western Mortgage Corp. v. Peacock*, 110 F.3d 222, 228 (3d Cir. 1997).

¹⁴ The question of the potentially negative impacts of private arbitration and other forms of alternative dispute resolution was the subject of a good deal of academic debate in the 1980s. See the large literature spawned by Owen Fiss’ article *Against Settlement*. Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073 (1984).

¹⁵ For an example of how increased reliance on arbitration can reduce the marginal production of legal rules by the courts, see recent comments by Justice Anthony Kennedy. Justice Kennedy remarked on the dearth of civil law cases before the Supreme Court and noted that arbitration is in part responsible for the decline in civil appeals: “The docket seems to be changing . . . A lot of big civil cases are going to arbitration . . . I don’t see as many of the big civil cases.” Pamela A. MacLean, *Justice Kennedy on Vanishing Big Civil Suits*, TRIAL INSIDER, (Aug. 16, 2011), <http://www.trialinsider.com/?p=639>.

¹⁶ William M. Landes & Richard Posner, *Adjudication as a Private Good*, 8 J. LEG. STUD. 235, 236 (1979).

nalities associated with formal adjudications—Delaware’s thick common law—are central to the value of Delaware’s corporate law franchise.¹⁷ To the extent that competition for adjudication leads to a diminution of Delaware’s network, this regime is a potential threat to Delaware’s competitive position as the competition for incorporations.

Delaware’s recent move to permit arbitration through the Chancery Court’s offices, relying on sitting chancellors to act as neutrals, is largely in response to the perceived threats of competition from private arbitration. If the recent movement of parties away from the formal legal system toward private ordering solutions in other commercial settings is any guide, it is conceivable that in the not-too-distant future, a substantial number of what are otherwise matters that might find themselves in front of a Delaware jurist might be decided elsewhere by a private arbitrator. Indeed, in its pleadings before the court in the citizens’ challenge and its public defense, Delaware regularly points to the potential threat of losing adjudications to arbitrators in New York, London, or Singapore as a motivation for implementing its court-sponsored procedure.¹⁸ The perceived long-term threat to Delaware’s central position in the corporate law as a result of adjudications moving overseas and elsewhere is obvious.

While Delaware’s move to open up the Chancery Court to arbitration may be understandable, it is a controversial step that raises at least two important questions. First, notwithstanding a strong presumption in favor of arbitration, there remain serious constitutional issues presented by the peculiar form of Delaware’s arbitration procedure. The First Amendment generally protects the right of the public to open courts and access to criminal and civil trials.¹⁹ Without a compelling justification, “agreement of trial judges and parties cannot constitutionally close a trial to the public.”²⁰ The arbitration procedure adopted by the state of Delaware, which relies on sitting chancellors to hear arbitral cases in confidence that might otherwise be heard in their courtrooms, puts the state directly in conflict with the First Amendment policy of open-

¹⁷ See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 841–51 (1995).

¹⁸ Brief for NASDAQ OMX Group Inc. & NYSE EuroNext as Amici Curiae Supporting Respondents at 8, *Del. Coal. for Open Gov’t v. Strine*, 2012 WL 3744718 (D. Del. Aug. 30, 2012) (No. 1:11-1015) [hereinafter *NASDAQ Amicus Brief*].

¹⁹ See *Richmond Newspapers v. Virginia*, 448 U.S. 555 (1980); *Publicker Indus., Inc. v. Cohen*, 733 F.2d 1059, 1070 (1984).

²⁰ *Richmond Newspapers*, 448 U.S. at 585. (Brennan, J., concurring).

ness. Indeed, in a citizens' challenge that is presently pending appeal before the Third Circuit, a federal district court in Philadelphia ruled that the confidentiality provisions of Delaware's arbitration procedure violate this qualified First Amendment policy of openness.²¹

Second, even if the new arbitration procedure ultimately withstands the constitutional challenge with respect to confidentiality of its proceedings, it is not clear that a confidential, state-sponsored arbitration system is in the long-term interests of Delaware and its corporate law franchise. Delaware's value as an incorporation destination stems directly from the value of its network. Delaware's thick corporate common law is regularly held out as a significant barrier to entry and is important to maintaining Delaware's competitive position relative to other states that might consider competing for incorporations but do not because of high barriers.²² The prospect of a "Star Chamber" for corporate litigation diverting what might be a significant portion of the court's docket into confidential arbitration—though ensuring short-term competitiveness in the market for adjudications—may well weaken Delaware's long-term position in the market for incorporations by diminishing Delaware's production of legal rules. Thus, it is not clear that the supposed benefits of a state-sponsored arbitration system in maintaining the present caseload outweigh the costs to Delaware's network over time through the reduction of rule production.

Finally, the creation of a Chancery-sponsored arbitration procedure raises normative questions. While it may not be in Delaware's long-term interest to, in effect, privatize the corporate law, there is still the question of whether society would be better off if parties could resolve corporate law questions out of the public eye through arbitration.²³ The answer to this question must be nuanced. It is certainly true that contracting parties, including shareholders and corporations, representing their own interests should be free to determine the manner and method of dispute adjudication. However, it is also true that courts play an important

²¹ *Del. Coal. for Open Gov't*, 2012 WL 3744718. See Tom Hals, *Backers of Secret Delaware Arbitrations See Grounds for Appeal*, REUTERS, Sept. 10, 2012, available at http://newsandinsight.thomsonreuters.com/Legal/News/2012/09_-_September/Backers_of_secret_Delaware_arbitrations_see_grounds_for_appeal/.

²² See Daines, *supra* note 7; Fisch, *supra* note 9; Kahan & Kamar, *supra* note 7.

²³ Different forms of this normative question have attracted attention over the years. For example, Professor Fiss sparked a debate within the alternative dispute resolution community during the mid 1980s on the question of the proper role of alternative forms of adjudication that lead to settlement. See Fiss, *supra* note 14.

role in generating positive externalities through their public rulemaking, in the absence of which private adjudication might be less valuable. Delaware's Chancery-sponsored arbitration procedure threatens to undo that balance, and, as a result, may not be socially optimal. This suggests that a balanced approach in which private arbitration exists side by side with formal adjudication may be optimal.

This Article proceeds as follows: Part II offers an overview of recent market developments in the use of arbitration in merger agreements. Although most attention with respect to arbitration deals with the problems of arbitration in the consumer contract context, relatively little attention has been paid to the role of arbitration in the context of complex contracting in "bet-the-company" transactions, such as merger agreements. Part III discusses Delaware's response to the increased popularity of arbitration and a rise in the perception that arbitration may be a competitive challenge to Delaware in the market for adjudications. The arbitration procedure adopted by the State of Delaware permits parties to use the good offices of the state's court system to confidentially adjudicate disputes. Part IV introduces a discussion of the constitutional challenges to Delaware's new arbitration system and the requirements for public access to the courts. Part V examines Chancery-sponsored arbitration in the context of Delaware's network for corporate law. This Part argues that notwithstanding a constitutional challenge, Delaware's state-sponsored arbitration system is bad public policy because it threatens the long-term value of the state's corporate law franchise. In addition, a state-sponsored system of private arbitration threatens to upset an important balance between the public production of legal rules and private adjudication. As a result, a state-sponsored private system of adjudication may not be socially optimal when compared to an approach in which private adjudication sits side-by-side with the public courts. Part VI addresses and evaluates the purported advantages of Chancery arbitration. In general, the advantages when compared to litigation before Chancery are few. To the extent there are advantages, these advantages are outweighed by the costs they impose on Delaware's corporate law network. There are also reasons to believe that, from a normative perspective, widespread utilization of Chancery arbitration would not be socially optimal. Part VII summarizes and concludes that if Chancery arbitration is successful, it may be more of a long-term threat to Delaware's corporate law

franchise than the perceived short-term threat it purports to mitigate.

II. OVERVIEW OF DEVELOPMENTS IN ARBITRATION

Arbitration has a long history in the United States.²⁴ Until the adoption of the FAA, there was an historical bias against arbitration by the courts.²⁵ In the FAA, Congress specifically provided that agreements between parties to enter into arbitration would be enforceable contractual provisions.²⁶ Over time, the Supreme Court issued a series of opinions, including *Southland Corp. v. Keating*, which made it clear that, in adopting the FAA, the United States “declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.”²⁷ This policy set aside years of anti-arbitration jurisprudence in favor of agreements to bring disputes before a private arbitrator. By now the use of arbitration and other non-traditional dispute resolution mechanisms has become well established in the context of consumer, labor, and commercial contracts.²⁸

The rise of arbitration, particularly in commercial settings, is not altogether surprising. The courts are notoriously overburdened, and consequently, the legal system operates at a slow pace. The prospects of that situation getting any better in times of fiscal austerity are less than promising. In addition, commercial disputes are often complex with generalist jurists ill placed to offer timely decisions without the benefit of a lengthy education by the parties on the subject matter of the dispute. On the other hand, private arbitration of commercial disputes offers parties a number of benefits that are not available through the formal legal

²⁴ See generally John Daly, *Arbitration: The Basics*, 5 J. AM. ARB. 1 (2006) (providing an overview of the development of arbitration in the United States).

²⁵ *Id.* at 7.

²⁶ The FAA pronounced that arbitration agreements between parties “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2 (1947).

²⁷ *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). See *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 272 (1995) (citing *Southland*, 465 U.S. 1); *Volt Info. Sciences, Inc. v. Bd. Of Trustees of Leland Stanford Jr. Univ.*, 489 U.S. 468, 478 (1989) (citing *Southland*, 465 U.S. 1).

²⁸ See Daly, *supra* note 24, at 9.

system, including speed, expertise of the decision-maker, flexibility, and confidentiality.

Whereas disputes that enter the formal legal system are required to queue with potentially a large number of other civil cases and compete for space on the docket, disputes that are managed through arbitration can be managed much more quickly. Because the parties have the freedom to select an arbitrator of their choosing, parties can select decision-makers who are experts with years of experience in the field in dispute. This expertise tends to eliminate the process of educating the decision-maker speeds up resolution of the dispute. Moreover, parties have significant flexibility in the design of the arbitral procedure, which can also aid in speeding the process. Arbitrators need not follow the same procedures as courts, permitting parties to expedite or limit discovery, modify rules of evidence and move more quickly than a court to a substantive decision on the merits.²⁹ Arbitrators selected by the parties are often only required to provide a resolution to the dispute before them and are not required to create, or necessarily adhere, to precedent.³⁰ Arbitrators' decisions can be extremely brief, providing only a "yes" or a "no" or a dollar amount, and not a lengthy opinion.³¹ This can expedite the process of dispute resolution considerably.

Some studies have found arbitration to be more common between parties who have ongoing business relationships that they wish to preserve.³² This suggests that arbitration is less confrontational than litigation in the courts.³³ Professors Christopher Drahozal and Stephen Ware suggest that businesses will tend to rely on arbitration in routine, small-stakes contracts, transnational contracts, and in contract situations where parties wish to maintain ongoing relationships. On the other hand, in high-stakes, "bet-the-company" litigation, they suggest parties are much less likely to rely on arbitration.³⁴ Because of their informal nature, arbitration proceedings can be kept confidential, thus protecting parties from potentially embarrassing disclosures. The ability of parties to

²⁹ See Nat'l Arb. Forum, *Business-to-Business Mediation/Arbitration vs. Litigation* (Jan. 2005) at 5.

³⁰ *Id.*

³¹ Soia Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 866 (1961).

³² Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RES. 433, 452 (2010).

³³ Nat'l Arb. Forum, *supra* note 29, at 8.

³⁴ Drahozal & Ware, *supra* note 32, at 452–56.

maintain confidentiality with respect to the content of their disputes may also play a role in reducing the level of confrontation.³⁵

Although arbitration has been generally recognized as more flexible, and even more efficient, for disputants than formal litigation, the prevalence of arbitration provisions in business-to-business commercial contracts is not universal in all contractual settings.³⁶ In fact, in a 2006 study of 2,800 public company contracts, Professors Theodore Eisenberg and Geoffrey Miller found that about eleven percent of all contracts in their sample included an arbitration provision.³⁷ Eisenberg and Miller found a greater prevalence of arbitration provisions when there was at least one international party, suggesting that the great certainty of enforcement of international arbitral awards is attractive for international parties.³⁸ Reliance on arbitration provisions in employment, licensing, and franchise settings is also relatively high, supporting the belief that arbitration can be valuable in supporting relational contracts.³⁹ The evidence with respect to the reliance on arbitration provisions in merger agreements is mixed. Eisenberg and Miller report arbitration provisions in 18.98 percent of merger agreements in their sample.⁴⁰

In a subsequent study of merger agreements involving publicly traded targets, Professors Matthew Cain and Steven Davidoff found that only two merger agreements of a sample of 1,020 (or 0.2 percent) include arbitration provisions.⁴¹ Cain and Davidoff state that the discrepancy in the prevalence of arbitration provisions in their sample is likely due to differences in sampling. A more recent study of merger agreements by Professor John Coates suggests this interpretation is likely correct. In a sample of public and private targets from 2007 and 2008, Professor Coates finds arbitration provisions governing contract disputes in twenty percent of trans-

³⁵ *Id.* at 452.

³⁶ See Landes & Posner, *supra* note 16 (arguing that if private adjudication is efficient, more will adopt it).

³⁷ Theodore Eisenberg & Geoffrey P. Miller, *The Flight From Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 336 (2007).

³⁸ *Id.* at 342, 351.

³⁹ *Id.* at 347, 350 (citing Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549, 575 (2003)).

⁴⁰ *Id.* at 351.

⁴¹ Matthew D. Cain & Steven M. Davidoff, *Delaware's Competitive Reach*, 9 J. EMP. LEG. STUD. 92, 105 (2012).

actions for private targets and in two percent of transactions for publicly traded targets.⁴²

A review of transactions from 2009–2011, during a period that overlaps with the implementation of Delaware’s Chancery-sponsored arbitration procedure, confirms observations by Cain and Davidoff and Coates.⁴³ Of the 248 transactions in the sample there is a clear bias in favor of both Delaware law to govern disputes over the merger contract (96%) and the Delaware judiciary to be the forum for the adjudication of disputes (84%). Only two transactions in the sample (less than 1%) opted for arbitration in any form, and both of those transactions opted for the new Delaware Chancery arbitration procedure.

Governing Law			Forum		
DE	238	95.97%	DE	209	84.27%
NY	6	2.42%	NY	8	3.23%
Other	4	1.61%	Other location	5	2.02%
Total	248	100.00%	Arbitration	0	0.00%
			Arbitration in DE	2	0.81%
			Nothing	24	9.68%
			Total	248	100.00%

It is clear from this data, as well as from the data presented by Cain and Davidoff and Coates, that the perception of arbitration as anything other than a long-term threat to the Delaware market for adjudications is likely mislaid. Although businesses appear happy to rely on arbitration in the consumer and employment contexts, consistent with observations by Professors Drahozal and Hylton, there is little or no evidence—notwithstanding the results of Eisenberg and Miller—that firms are presently seeking to exit the formal legal system in favor of private arbitration in large “bet-the-company” transactions. There is even less evidence to support the contention that United States firms are seeking to have merger-related disputes adjudicated overseas. Chancery arbitration may be, it turns out, a solution in search of a problem. If the procedure does not take hold, that might not be much of a concern. However, if

⁴² John C. Coates, *The Powerful and Persuasive Effects of Ownership on M&A* (2012), available at ssrn.com/abstract=1544500. Professors Coates found a larger percentage of merger agreements included arbitration provisions for resolution of post-closing disputes over price adjustments (twenty-five percent for publicly traded targets and eighty-nine percent for private targets). *Id.* at 24.

⁴³ A search of the SDC Thomson Database for transactions announced between Jan. 1, 2009 and Dec. 31, 2011 greater than \$100 million in value involving Delaware targets not in bankruptcy turns up 248 deals.

the procedure becomes a popular alternative to formal adjudication, then it could pose a challenge to the viability of Delaware's franchise.

III. DELAWARE'S ARBITRATION PROCEDURE

The question of competition for corporate law and Delaware's role in competing with other states for incorporations has been well studied.⁴⁴ While state competition for incorporations may once have been robust, by now such competition is more theoretical than real. Delaware has by far the largest share of out-of-state incorporations. To the extent there is any remaining competition for incorporations, it is bi-modal in nature: Delaware competes for re-incorporations with the state in which firms are physically located. Notwithstanding efforts by states like California and New York to the contrary, there is almost no real competition between Delaware and third states for incorporations of firms.⁴⁵

Rather, as others have previously noted, Delaware's most salient source of potential competition comes from the federal government, not for incorporations, but rather in the corporate governance sphere.⁴⁶ While the federal government has the power to preempt the question of state law dominance over incorporations, it has opted not to. Rather, it has largely, but not entirely, left the question of the internal governance of the firm to the states.⁴⁷ Over the years, and especially since the adoption of the Sarbanes-Oxley legislation in 2002, the federal government has

⁴⁴ See Lucian A. Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003); Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553 (2002); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); Kahan & Kamar, *supra* note 7; Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908 (1998); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987); Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843 (1993); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002); Winter, *supra* note 6.

⁴⁵ See Daines, *supra* note 7, at 1573–74.

⁴⁶ Roe, *supra* note 8, at 593, 600. See generally Renee Jones, *Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate*, 41 WAKE FOREST L. REV. 879 (2006); Jones, *supra* note 8; Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1576, 1578–90 (2005); Brett H. McDonnell, *Two Cheers for Corporate Law Federalism*, 30 J. CORP. L. 99 (2004).

⁴⁷ See *Edgar v. Mite Corp.*, 457 U.S. 624 (1982).

made episodic forays into the question of corporate governance.⁴⁸ These interventions have largely been in response to perceived national problems related to corporate governance and performance of the corporate sector. For example, Sarbanes-Oxley was adopted in the wake of the dot com bubble and the accounting scandals of the early 2000s. The more recent Dodd-Frank Act, with its corporate governance provisions, was also adopted in response to the bursting of the credit bubble in 2007. The responsive approach to corporate governance interventions has been criticized by some observers for its incoherence.⁴⁹

Delaware is sensitive to its position *vis-a-vis* the federal government and is highly responsive to moves that might impinge on its position. For example, in 2006, in response to potential movement by the Securities and Exchange Commission (“SEC”) on the question of majority voting for directors, the Delaware legislature amended §216 of the Delaware General Corporation Code to provide that, where shareholders approve a bylaw amendment requiring majority voting for directors, the directors may not further amend such bylaws.⁵⁰ Delaware has taken similar steps with respect to shareholder proxy access by adopting private ordering solutions, like §112, in order to head off potential top-down governance interventions threatened by the SEC.⁵¹ Delaware’s responsiveness to potential federal government action suggests that competition, or at least the threat of competition, in corporate governance is perceived to be real. Rather than sit idly on its market-leading position, Delaware is highly attuned to the tension that exists between it and other players in the governance sphere, and will take steps to reform its governance mechanisms when it senses a potential threat to its position on the horizon.⁵²

In recent years, a new sphere for competition with Delaware has developed: the market for adjudications. To the extent adjudications play an important role in creating legal precedents and thus maintaining and developing a thick corporate common law, Delaware’s continued ability to adjudicate corporate law disputes

⁴⁸ See Roe, *supra* note 98, at 597–8; Jones, *supra* note 46, at 887.

⁴⁹ See Jones, *supra* note 46, at 882–88; Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 *YALE L.J.* 1521 (2005).

⁵⁰ DEL. CODE ANN. tit. 8, § 216 (2006).

⁵¹ DEL. CODE ANN. tit. 8, § 112 (2008) (permitting firms to adopt bylaws that provide shareholders, under certain circumstances, the right to nominate directors and have access to the proxy).

⁵² Roe, *supra* note 8. See Jones, *supra* note 46; Kahan & Rock, *supra* note 46; McDonnell, *supra* note 46.

before its Chancery Court plays an important role in maintaining its franchise. The specialized Chancery Court is one of the sources of Delaware's competitive advantage in corporate law. Professors John Armour, Bernard Black and Brian Cheffins observed a relatively recent trend of plaintiffs bringing shareholder litigation outside the state of Delaware and its Chancery Court.⁵³ The fact that an increasingly large number of litigants would bring claims away from the Delaware Chancery Court by pursuing multi-forum litigation strategies raises questions about Delaware's ability to maintain barriers to entry that help maintain its position against potential competition.⁵⁴

Unlike corporate law, the market for adjudication appears to be more open to competition. In recent years, nineteen states have established specialized business litigation courts.⁵⁵ In New York, the establishment of the Commercial Division of the New York Supreme Court was intended to put New York at the center of the market for adjudications.⁵⁶ In fact, in 2012, the Chief Judge of New York, Jonathan Lippman, created a Task Force with the goal of ensuring that New York's courts remain at the forefront of the market for adjudication of commercial disputes.⁵⁷ In other states, the focus of developing specialized business courts was clearly "defensive competition" in response to lobbying by local businesses to prevent them from exiting the state's court system for other forums.⁵⁸

Non-traditional dispute resolution procedures, like private arbitration, also raise potential competitive issues with respect to Delaware. To the extent parties opt to exit the formal legal system to have their disputes resolved through arbitration or mediation,

⁵³ Armour, Black, & Cheffins, *supra* note 10, at 1353–63.

⁵⁴ See Quinn, *supra* note 10, at 139.

⁵⁵ "In 1993, business courts were established in New York and Illinois. In the years to follow, business courts were created in North Carolina (1995), New Jersey (1996), Pennsylvania (2000), Massachusetts (2000), Nevada (2000), Rhode Island (2001), Maryland (2003), Florida (2004), Georgia (2005), Oregon (2006), Colorado (2006), South Carolina (2007), Maine (2008), New Hampshire (2008), Alabama (2009), Ohio (2009), and Delaware (2010)." John F. Coyle, *Business Courts and Interstate Competition*, 53 WM. & MARY L. REV. 1915, 1918 (2012).

⁵⁶ THE CHIEF JUDGE'S TASK FORCE ON COMMERCIAL LITIGATION IN THE 21ST CENTURY (June 2012) [hereinafter TASK FORCE].

⁵⁷ *Id.* at 1.

⁵⁸ Kahan & Kamar, *supra* note 7, at 699. See also *Business Courts May Help West Virginia Compete*, CHARLESTON DAILY MAIL, Sept. 13, 2012 available at <http://www.dailymail.com/Opinion/Editorials/201209120220>.

exit forms another locus of potential competition for Delaware.⁵⁹ In recent years, the potential for competition with the Delaware Chancery Court engendered by informal processes has attracted the attention of Delaware policymakers who have responded in kind. In 1994, Delaware created “summary proceedings” in an attempt to bridge the gap between private arbitration and traditional litigation.⁶⁰ Then, in 2003, Delaware adopted a mediation-only device in an attempt to provide still more flexibility for parties bringing cases before the Delaware courts.⁶¹ In 2010, Delaware created yet another forum for adjudication of business disputes when it established a new Complex Commercial Litigation Division in its Superior Court to hear commercial contract disputes.⁶² All three of these devices were adopted in an attempt to improve the competitiveness of Delaware relative to new private alternatives in the market for adjudications.

In 2009, in response to perceived threats to Delaware’s position stemming from informal adjudication procedures like arbitration, the Delaware legislature made additional amendments to Title 10 related to the powers and jurisdiction of the Chancery Court. That the legislative record is sparse with respect to the legislative history for this amendment speaks to the consensus-oriented process that governs legislative changes with respect to the Delaware corporate law. The amendments, supported by the Delaware Bar Association’s committee on the corporate law, were adopted by the Delaware legislature without debate. *Ex post* rationalizations for the law suggest that the corporate law community in Delaware believed that adoption of the Delaware arbitration procedure was necessary to head off potential competition from private arbitrators in the corporate law space. The new §349 provides:

- (a) The Court of Chancery shall have the power to arbitrate business disputes when the parties request a member of the Court of Chancery, or such other person as may be authorized under rules of the Court, to arbitrate a dispute.

⁵⁹ ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY* (1970) (observing the competitive effect of exit in governance).

⁶⁰ See Brenda G. Houck, *Recent Developments in Delaware Corporate Law: 1994 Statutory Amendments to the Delaware General Corporation Law*, 20 DEL. J. CORP. L. 477, 477–87 (1995).

⁶¹ Leo E. Strine, Jr., “Mediation-Only” Filings in the Delaware Court of Chancery: *Can New Value be Added by One of America’s Business Courts?*, 53 DUKE L. REV. 585, 585 (2003) (noting the mediation-only device was enacted into law as §§346 and 347 of Title 10 of the Delaware Code).

⁶² DEL. ST. CTS., SUPER. CT. COMPLEX COMMERCIAL LITIG. DIV., available at <http://courts.delaware.gov/Superior/complex.stm>.

(b) Arbitration proceedings shall be considered confidential and not of public record until such time, if any, as the proceedings are the subject of an appeal. In the case of an appeal, the record shall be filed by the parties with the Supreme Court in accordance with its rules, and to the extent applicable, the rules of the Court of Chancery.⁶³

Although parties have the right to appeal arbitral proceedings to the Delaware Supreme Court under §349, such appeals are subject to a voluntary *ex ante* waiver; thus it is possible to use the Chancery Court's offices, with a sitting chancellor or vice chancellor acting as arbitrator, to conduct a confidential, non-appealable arbitration proceeding.⁶⁴

The availability of this new Chancery Court-sponsored arbitration procedure is not universal. The arbitration procedure requires that both parties consent to arbitration over mediation and that at least one party be a business incorporated in Delaware.⁶⁵ Parties have limited rights with respect to arbitral remedies; unlike the Chancery Court's typical jurisdiction, the arbitration procedure only provides for cash damages (minimum of one million dollars), and not equitable remedies.⁶⁶ Of course, parties are free to rewrite the powers of the arbitrator in any manner that suits them.⁶⁷ This includes granting the arbitrator the right to exercise equitable powers. In both transactions in the author's sample the parties granted the arbitrator the right to fashion any remedy that the arbitrator deemed appropriate.

The Chancery Court arbitration procedure also ensures confidentiality for the parties.⁶⁸ Parties are responsible for paying costs, including an arbitration fee.⁶⁹ Parties can agree to an *ex ante* waiver of their right to appeal to the Delaware Supreme Court, in which case the decision of the chancellor arbitrator is final.⁷⁰ In the event parties do not waive their rights to appeal the arbitral decision and they opt to appeal, the appeal is limited by the FAA

⁶³ DEL. CODE ANN. tit. 10, § 349 (2012).

⁶⁴ See DEL. CODE ANN. tit. 10, § 351 (2012).

⁶⁵ DEL. CODE ANN. tit. 10, § 349(a) (2012). No party to the arbitration may be a "consumer" as defined in Sec. 2731 of tit. 6 of the Del. Code. §.2731 defines a consumer as "an individual who purchases or leases merchandise primarily for personal, family or household purposes." This definition would exclude most, if not all, stockholders if arbitration were to be applied to them as stockholders.

⁶⁶ *Id.*

⁶⁷ DEL. CH. R. 98(f).

⁶⁸ DEL. CODE ANN. tit. 10, § 349(b) (2012).

⁶⁹ DEL. CH. R. 98(g).

⁷⁰ DEL. CODE ANN. tit. 10, § 349(c) (2012).

to questions about whether the arbitration provision was properly entered into by the parties and not the substance of the arbitration proceedings.⁷¹

This new Chancery-sponsored arbitration procedure is unique to Delaware. Although there are numerous examples of court-annexed arbitration programs throughout the United States, such programs are different from the Chancery-sponsored arbitration procedure. First, these court-annexed arbitration procedures are, in their essence, diversion programs intended to move simple cases of relatively low values out of the formal legal system.⁷² The purpose of the Chancery Court-sponsored procedure is to deter parties from bringing claims in arbitration in other forums outside of Delaware. Rather than be a diversion program and reduce the load on the courts, Delaware's arbitration program is intended to attract additional parties to Delaware as an adjudication destination. Delaware hopes to attract new adjudications, or to at least prevent parties who might traditionally adjudicate in Delaware from leaving the jurisdiction for other forums.

Second, arbitrators in more traditional court-annexed arbitration programs are typically members of the bar, retired judges, or specialists and not, as in Delaware, sitting judges.⁷³ Because traditional court-annexed programs are intended to be diversion programs, the use of attorneys and retired judges rather than sitting judges reduces the case-load of the formal court system and improves the ability of the formal legal system to resolve the cases that remain in the docket. On the other hand, the Chancery Court program *adds* to the court's case-load by requiring sitting judges to act as private arbitrators, thus raising their prospective caseload. Indeed, the prospect of having sitting judges available to resolve controversies is intended to provide prospective parties with confidence that the matter will be resolved by an expert adjudicator. The use of sitting judges rather than private experts is, in the design

⁷¹ *Id.* In arguments before the Federal district court in Philadelphia, the Delaware State Bar Association's amicus brief stated that appeals would be limited by the FAA's limitations on appellate review of arbitration decisions. That is, such appeals would be limited to reviews of the parties' agreement to arbitrate. Brief for the Delaware Bar Association as Amici Curiae Supporting Respondents, *Del. Coal. for Open Gov't v. Strine*, 2012 WL 3744718 (D. Del. Aug. 30, 2012) (No. 1:11-1015) [hereinafter *Del. Bar Ass'n Amicus Brief*]. See David Horton, *Federal Arbitration Act Preemption: Purposivism and State Public Policy*, 101 *GEO. L.J.* (forthcoming 2013) (discussing FAA limits on parties' right to appeal arbitration decisions).

⁷² PATRICIA A. EBENER & DONNA R. BETANCOURT, *COURT-ANNEXED ARBITRATION: THE NATIONAL PICTURE* (Instit. for Civil Justice, Feb. 1985); BARBARA S. MEIERHOFER, *COURT-ANNEXED ARBITRATION IN TEN DISTRICT COURTS* (Fed. Judicial Ctr. 1990).

⁷³ EBENER & BETANCOURT, *supra* note 72; MEIERHOFER, *supra* note 72.

of the Chancery arbitration procedure, a “feature” rather than a “bug.”

Finally, cases in court-annexed arbitration programs typically rely on case managers to identify matters eligible for diversion into the program. Case managers are instructed to divert small cases with relatively straightforward issues.⁷⁴ On the other hand, the Chancery Court procedure does not rely on a case manager to decide which cases to resolve through arbitration; the parties themselves must elect through contract to pursue arbitration. With respect to appropriate matters, rather than limit the size at risk, the Chancery Court requires that the amount in controversy be at least one million dollars. That is to say, it demonstrates a bias towards larger controversies. Though diversion programs limit themselves to relatively simple sets of facts, there are no limits with respect to the complexity of the facts at issue in the Chancery Court procedure.

The Chancery-sponsored arbitration program is also different in kind from court-sponsored mediation programs, including Delaware's court-sponsored mediation program. In mediation programs, parties agree to participate in confidential proceedings that rely on the court's good offices, and, in Delaware, a chancellor of the court. However, mediation and other court-sponsored settlement procedures by their nature lack the coercive force of either formal adjudication or arbitration. Parties in these procedures always reserve the right to pursue litigation in the event they are unhappy with the result of the mediation or settlement. This measure of background voluntariness is absent when parties agree to arbitration.

Although intended for large commercial contracts like mergers, the Delaware arbitral program has the potential for bigger and potentially unanticipated effects if it finds purchase in corporate formation documents and then in shareholder litigation. While perhaps not initially intended as a device for firms to resolve shareholder disputes, it is entirely possible following a policy change at the SEC that Chancery-sponsored arbitration could come into widespread use as a method for stemming shareholder litigation.

In recent years, transaction-related litigation has become a regular landmark of the deal-making cycle.⁷⁵ By some estimates, more than eighty percent of merger transactions are accompanied

⁷⁴ EBENER & BETANCOURT, *supra* note 72; MEIERHOFER, *supra* note 72.

⁷⁵ Armour, Black, & Cheffins, *supra* note 10.

by some form of shareholder litigation.⁷⁶ Arbitration provisions included in a merger agreement cannot prevent shareholders from bringing transaction-related lawsuits before a court since shareholders are not bound by the merger contract's limitation in pursuing arbitration as a proper forum. If, however, agreements to arbitrate are included as forum-selection provisions in corporate charters, then the Chancery arbitration procedure may also include shareholder litigation.⁷⁷ If it does, it has the potential to significantly impact the development of the corporate law over time.

To date, the SEC has not permitted firms to go public with arbitration provisions in their certificates of incorporation.⁷⁸ Such provisions would, in the opinion of SEC staff, violate the anti-waiver provisions of §14 of the Securities Act and §29(a) of the Securities Exchange Act.⁷⁹ The anti-waiver provisions prohibit parties from entering into contracts or agreements that might purport to waive any provisions of the securities acts.⁸⁰ The SEC staff has maintained the position that arbitration provisions are a waiver, and thus invalid. However, the Supreme Court has been consistent in its policy, "requiring a liberal reading of arbitration agreements," and maintaining "that as a matter of federal law, any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration."⁸¹ This liberal policy with respect to arbitration suggests that if the SEC were forced by a change in administration to reconsider its present policy with respect to arbitration provisions that it could do an about face. In addition, the SEC already permits forum selection clauses in charters that purport to limit shareholders to Delaware or other preferred forums. Thus, there is increasingly little reason to expect that the SEC's aversion to arbitration will survive indefinitely into the future. If the SEC were to reverse its present position, it is possible that firms would rapidly adopt such provisions in their charter documents and, as a

⁷⁶ *Id.*

⁷⁷ Jennifer Johnson & Edward Brunet, *Arbitration of Shareholder Claims: Why Change is Not Always a Measure of Progress* (Lewis & Clark Law School, Working Paper No. 2008-11, 15-16), available at ssrn.com/abstract=1112826.

⁷⁸ See Steven M. Davidoff, *Carlyle Readies an Unfriendly I.P.O. for Shareholders*, THE N.Y. TIMES (Jan. 18, 2012), <http://dealbook.nytimes.com/2012/01/18/carlyle-readies-an-unfriendly-i-p-o-for-shareholders/>.

⁷⁹ Barbara Black, *Can Behavioral Economics Inform Our Understanding of Securities Arbitration?*, CINCINNATI LAW WORKING PAPER SERIES, 11-13 (Aug. 1, 2011), at 3.

⁸⁰ See generally Samuel H. Gruenbaum, *Avoiding the Protections of the Federal Securities Laws: The Anti-Waiver Provisions*, 20 SANTA CLARA L. REV. 49 (1980).

⁸¹ *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-5 (1983).

consequence, shift a considerable amount of shareholder litigation to arbitration.⁸²

IV. CONSTITUTIONAL CHALLENGES TO DELAWARE'S ARBITRATION SYSTEM

Delaware's peculiar arbitration system raises a serious constitutional question: may the State sponsor a confidential system of dispute adjudication that relies on sitting state judges hearing matters identical to those that they would otherwise hear through the formal legal system? Not long after the Skyworks/AATI dispute was made public, the Delaware Coalition for Open Government ("DCOG") filed suit arguing that the confidentiality afforded to parties through the Chancery-sponsored arbitration system was unconstitutional because it denied the public access to the proceedings.⁸³ The DCOG argued successfully in federal district court that the Chancery-sponsored arbitration system violated a First Amendment policy of open access to the courts.⁸⁴ Notwithstanding its failure to pass constitutional muster before a district court, and a pending appeal before the United States Court of Appeals for the Third Circuit, backers of Chancery arbitration seek to reconfigure the procedure and pursue it in an alternate form.⁸⁵

Proponents of Delaware's Chancery-sponsored arbitration procedure hail it as an important tool in ensuring that Delaware remains a competitive locus for adjudications competing with private arbitration. Central to this competitiveness argument is the fact that the new Chancery-sponsored arbitration procedure provides parties with access to Delaware's stable of highly expert judges, while ensuring the results of the arbitration remain confidential.⁸⁶ Proponents of the arbitration program point to the importance of confidentiality in maintaining a competitive position relative to private arbitration, which is typically confidential in na-

⁸² See generally Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 JLEO 83 (2001) (observing that many firms go public with less than efficient terms notwithstanding predictions that they should only go public with efficient terms)

⁸³ Complaint, *Del. Coal. for Open Gov't v. Strine*, 2012 WL 3744718 (D. Del. Aug. 30, 2012) (No. 1:11-1015).

⁸⁴ *Del. Coal. for Open Gov't*, 2012 WL 3744718.

⁸⁵ Hals, *supra* note 21.

⁸⁶ Del. Bar Ass'n Amicus Brief, *supra* note 71.

ture.⁸⁷ However, the provision for the broad protections of confidentiality for the arbitration proceedings places it squarely at odds with long-held notions of openness of court proceedings and a qualified First Amendment right of public access to the courts.

The U.S. Supreme Court has long adhered to an interpretation of the First Amendment application that requires the public and press have open access to the courts. In *Richmond Newspapers v. Virginia*,⁸⁸ the trial judge in a criminal case cleared the court of non-parties and witnesses on a defense motion. The prosecution did not object to the defense motion and deferred to the court's decision. A local newspaper challenged the court's decision to close the courtroom arguing that, notwithstanding an agreement between the defense and the prosecution to close the courtroom from outsiders, the public through the press had the right to access the proceeding. On appeal, the U.S. Supreme Court agreed with the newspaper and announced a First Amendment policy of the presumption of open access to criminal trials.⁸⁹ The *Richmond Newspapers* court noted that traditional public access to the common law courts was "one of the essential qualities of a court of justice."⁹⁰ This policy of openness was brought over to the colonies. In its decision, the Court cited the *1677 Concessions and Agreements of West New Jersey*, which provided:

That in all public courts of justice for trials of causes, civil or criminal, any person or persons, inhabitants of the said Province may freely come into, and attend the said courts, and hear and be present, at all or any such trials as shall be there had or passed, that justice may not be done in a corner nor in any covert manner.⁹¹

The presumption of openness of the courts is thus engrained in the tradition of the common law system in the United States. Indeed, the law-making role of the courts requires public access to them in order to ensure their legitimacy over the long run. As the court in *Richmond Newspaper* noted, "[p]eople in an open society do not demand infallibility from their institutions, but it is difficult for them to accept what they are prohibited from observing."⁹²

⁸⁷ *Id.*; NASDAQ Amicus Brief, *supra* note 18, at 6–7. See also Peg Brickley, *Secrecy Puts Judges on Defense in Delaware*, WALL ST. J. (Feb. 21, 2012), <http://online.wsj.com/article/SB10001424052970204131004577235240702540000.html>.

⁸⁸ 448 U.S. 555 (1980).

⁸⁹ *Id.*

⁹⁰ *Id.* at 567 (citing *Daubney v. Cooper*, 10 B. & C. 237, 240 (K. B. 1829)).

⁹¹ *Id.* (citing R. PERRY, ED., *SOURCES OF OUR LIBERTIES* 188 (1959)).

⁹² *Id.* at 572.

The role of public access is therefore critical to the development of the common law.

Of course, there are a number of settings where the proper functioning of the courts and public access are not altogether appropriate, such as in the context of grand juries or jury deliberations.⁹³ Before a “qualified First Amendment right of access” attaches to a particular court proceeding, two factors must be considered: First is “whether the place and process have historically been open to the press and general public.”⁹⁴ The more experience with openness with respect to the particular place and process, the more likely it is that this experience factor will lean in favor of openness. “The experience factor considers whether there is a ‘tradition of accessibility’ attendant to a given place and process.”⁹⁵ Second is the “logic” factor, which “asks whether public access plays a significant positive role in the functioning of the particular process in question.”⁹⁶ One can well imagine that public access into jury deliberations or grand jury proceedings might well negatively affect the functioning of the process of fact determination. On the other hand, public access to the court’s rationalization of the verdict could play a very valuable role in improving consistency of outcomes.

Although the Supreme Court has never directly reached the question of whether the qualified First Amendment right of access reaches civil proceedings, all the circuits that have heard the question (with the exception of the D.C. Circuit) have extended the qualified First Amendment right of access to civil cases as well.⁹⁷ For example, in *Publicker Industries, Inc. v. Cohen*,⁹⁸ the Third Circuit was asked to rule on a question of first impression in that circuit: “Does the First Amendment secure to the public and to the press a right of access to civil proceedings?”⁹⁹ In *Publicker*, members of the media objected to the decision by a judge in the Delaware Orphans Court (precursor to the Delaware Chancery Court)

⁹³ *Press-Enter. v. Super. Ct.*, 478 U.S. 1, 9 (1986).

⁹⁴ *Id.* at 8.

⁹⁵ *Id.*

⁹⁶ *Id.* at 9.

⁹⁷ Ronald D. May, *Public Access to Civil Court Records: A Common Law Approach*, 39 VAND. L. REV. 1465, 1478 (1986); Mary-Rose Papandrea, *Under Attack: The Public’s Right to Know and the War on Terror*, 25 B.C. THIRD WORLD L.J. 35, 47 (2005) (citing Eugene Cerruti, “Dancing in the Courthouse”: *The First Amendment Right of Access Opens a New Round*, 29 U. RICH. L. REV. 237, 263 (1995)).

⁹⁸ *Publicker Indus., Inc. v. Cohen*, 733 F.2d 1059 (3d Cir. 1984).

⁹⁹ *Id.* at 1061.

to close proceedings in shareholder litigation to members of the media. The judge closed the hearing to all except the parties, their counsel, and witnesses, due to the sensitive nature of the information to be discussed and because the nature of the hearing was to determine whether such information should be subject to a protective order.¹⁰⁰ Members of the media challenged the order, arguing that the qualified First Amendment right recognized in *Richmond Newspapers* and its progeny extend the policy of openness to civil as well as criminal trials.

In extending the qualified First Amendment right of access to civil cases, the *Publiker* court dealt with the most serious objection to the right of access in the civil context: the fact that two parties to a civil case may wish to adjudicate their civil matter in private. The justification of openness where one party to the proceeding is exercising governmental police powers against a citizen is obvious—the fact that the public may observe the actions of the government and the court ensures against over-reach and instills confidence in the integrity of the judicial system.¹⁰¹ Citing Justice Oliver Wendell Holmes, the *Publiker* court noted the desirability of public civil trials:

Not because the controversies of one citizen with another are of public concern, but because it is of the highest moment that those who administer justice should always act under the sense of public responsibility, and that every citizen should be able to satisfy himself with his own eyes as to the mode in which a public duty is performed.¹⁰²

It is precisely because openness can instill confidence in the operation of the courts for non-participants that it is important to maintain openness, even where there are only private parties involved and the government is not a party. In civil cases, it is the ability of the courts to demonstrate even-handedness in the resolution of disputes between private parties that is the function worth protecting. By instilling and reinforcing public confidence in the ability of courts to operate, openness increases the value of public courts for third parties.

¹⁰⁰ *Id.* at 1062.

¹⁰¹ The Supreme Court's recognition of a First Amendment right of access to *criminal* trials is predicated on the common understanding that "the core purpose of the First Amendment is to assure freedom of communication on matters relating to the functioning of government." *Id.* at 1067 (1984) (citing *Globe Newspaper Co. v. Sup. Ct.*, 457 U.S. at 575, 604). See *Richmond Newspapers*, 448 U.S. 555 (1980).

¹⁰² 733 F.2d at 1061 (citing *Cowley v. Pulsifer*, 137 Mass. 392, 394 (Mass. 1884)).

Once the qualified First Amendment right of access has attached, parties seeking to close presumptively open proceedings must establish “an overriding interest based on findings that closure is essential to preserve higher values and is narrowly tailored to serve that interest.”¹⁰³ Courts have held that there are various categories of witnesses who have a privacy interest paramount to the qualified First Amendment right of access, including victims of sex crimes and criminal informants, and permit closure of the court record with respect to their identities.¹⁰⁴ For example, in *Catholic Diocese of Wilmington, Inc.*, a federal bankruptcy court recognized a “common law right of access” in civil proceedings in determining whether certain personnel records related to the sexual abuse of minors would be subject to public disclosure.¹⁰⁵ A closure in such a case would recognize the “higher values” associated with, for instance, releasing the identities of abused victims as compared to the public’s qualified right of access. The court may issue a protective order “narrowly tailored to serve that interest” without compromising the greater principle of open access.¹⁰⁶ Through the use of narrowly tailored protective orders, courts can balance the interest in openness with the interests of the parties in maintaining at least some degree of confidentiality without sacrificing the important contributions that openness generates for the judicial system.

We must also consider the role of confidentiality. Confidentiality of the proceedings is the key attribute of the Chancery Court’s arbitration procedure. However, if one applies the two-factor test to the typical case that one might expect to be heard by the Chancery Court, it is difficult to make a compelling argument against the presumption of a qualified First Amendment right of access. The mere fact that parties have elected to pursue voluntary arbitration through the courts should not be sufficient to restrict public access to the proceedings. The types of cases that one expects will avail themselves of the Chancery Court’s arbitration program (e.g. contract disputes and shareholder litigation) are not the types of cases where one expects there to be compelling governmental in-

¹⁰³ *Press Enter. v. Sup.Ct.*, 464 U.S. 501, 510 (1984).

¹⁰⁴ *U.S. v. Ignasiak*, 667 F.3d 1217 (11th Cir. 2012) (declining to find a compelling interest in protecting the privacy of an expert witness’ fee).

¹⁰⁵ *In re Catholic Diocese of Wilmington, Inc.*, Case No. 09-13560 (CSS) (June 20, 2012) (J. Sontchi).

¹⁰⁶ In *Catholic Diocese of Wilmington, Inc.*, the Court acknowledged the public interest in the Diocese case, in particular, where “[t]he very heart of the heavily negotiated Non-Monetary Provisions was and is to shed light on the abuse of children by Catholic priests and the Church’s cover up of that abuse.” *Id.*

terest in maintaining the secrecy of the proceedings. As Judge Easterbrook noted:

Many a litigant would prefer that the subject of the case—how much it agreed to pay for the construction of a pipeline, how many tons of coal its plant uses per day, and so on—be kept from the curious (including its business rivals and customers), but the tradition that litigation is open to the public is of very long standing.¹⁰⁷

All this suggests is that a court-sponsored arbitration program of the type being implemented by the Delaware Chancery Court runs afoul of the qualified First Amendment right of access. Indeed, it was along these lines that the district court ruled that a qualified First Amendment right of access applies to Chancery arbitration proceedings.¹⁰⁸

The fact that parties engage in arbitration before a sitting chancellor is not sufficient to reach a determination that confidentiality of the proceedings is appropriate. The label given to the activity before the court is not sufficient to determine the outcome of the analysis.¹⁰⁹ Rather, courts will apply an “experience” factor to the analysis of whether a particular proceeding is of the type that is traditionally open to the public and the beneficiary of a qualified First Amendment right of access.¹¹⁰ Pursuant to the Chancery rules, the typical claim that one might expect to hear in arbitration before a chancellor of the Chancery Court is a commercial contract claim, a merger agreement, or shareholder litigation against or on behalf of the company.¹¹¹ Such claims are of the type that usually appear before the Chancery Court in a formal session.

Take for example the dispute between Skyworks and AATI that was heard before a chancellor in arbitration before the Chancery Court. In the Skyworks/AATI dispute, Skyworks petitioned the chancellor in arbitration for a declaratory judgment that AATI was in breach of the merger agreement signed by the parties, and that Skyworks was entitled to terminate the contract or, in the alternative, to receive damages.¹¹² AATI also filed a petition with the chancellor seeking a declaratory judgment from the chancellor

¹⁰⁷ *Union Oil Co. v. Leavell*, 220 F.3d 562, 568 (7th Cir. 2000).

¹⁰⁸ See *Del. Coal. for Open Gov't*, 2012 WL 3744718 at 11.

¹⁰⁹ See *Press-Enter.*, 478 U.S. at 7.

¹¹⁰ *Id.* at 8.

¹¹¹ However, Delaware’s Complex Commercial Litigation Division of the Superior Court of Delaware is intended to hear commercial contract claims that are not associated with shareholder claims or corporate law issues.

¹¹² *Skyworks Solutions, Inc.*, Form 8-K (Oct. 11, 2011).

that AATI had not breached the merger agreement and that no “material adverse effect” had occurred with respect to AATI.¹¹³ AATI sought specific performance of the merger agreement and an order for Skyworks to close the transaction.¹¹⁴

Disputes over merger agreements, like that in the Skyworks/AATI controversy, are typical of the kinds of cases traditionally heard by chancellors in the Chancery Court.¹¹⁵ Such disputes have been traditionally open to the press and the general public. Decisions by the chancellors in these kinds of claims are made pursuant to sometimes lengthy opinions, providing the parties and the public a rationale for the outcome. Such was not the case in the Skyworks/AATI dispute, where the parties brought their merger dispute before a sitting chancellor pursuant to the Delaware arbitration procedure. Notwithstanding the fact that the parties called the proceeding an arbitration and sought to have it heard confidentially, the experience factor weighs heavily in favor of openness. In the absence of the arbitration procedure, this claim would have been heard before the same chancellor who would have publicly reviewed the evidence and then issued a public rationale for his decision.¹¹⁶ That is to say, there is no substantive difference between the arbitration procedure before the Chancery Court and a formal judicial proceeding before the Chancery Court.¹¹⁷ The experience factor therefore weighs in favor of openness.

The second factor is the logic factor—whether logic dictates that access to the proceeding of a particular government process, in this case the Chancery-sponsored arbitration program, by the public is “important in terms of that very process.”¹¹⁸ In disputes between private parties in contract, logic does not necessarily dictate a role for public access to the process of dispute resolution. In-

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ See, e.g., *United Rentals, Inc. v. Ram Holdings*, 937 A.2d 810 (Del. Ch. 2007); *In re IBP Shareholders Litigation*, 789 A.2d 14 (Del. Ch. 2001); *Frontier Oil Corp. v. Holly Corp.*, 2005 WL 1039027 (Del. Ch. 2005).

¹¹⁶ On the other hand, the Chancery Court has for the past decade implemented a voluntary mediation-only program. In addition, the Chancery Court has a history of using its offices to facilitate voluntary settlements of disputes. Although final settlements become part of the public record because they must be approved by the court and are thus subject to public review, the negotiations leading up to the settlements are confidential.

¹¹⁷ Although the legislation purports to limit arbitration proceedings to claims where parties seek only a cash remedy, in the recent Skyworks/AATI dispute the parties sought equitable remedies. The arbitration procedure is flexible enough to permit parties to contract for equitable remedies notwithstanding the statutory limitation.

¹¹⁸ *Richmond Newspapers v. Virginia*, 448 U.S. at 555, 589 (1980).

deed, one can argue for the same reasons that the Supreme Court has developed jurisprudence in favor of arbitration that private parties, in contract, should be free to take their disputes out of the public realm and decided in alternate forums. However, to the extent publicly traded corporations are involved in Chancery-sponsored arbitration, it would seem that the confidentiality of the process would be inimical to the purpose of the shareholder proceeding.¹¹⁹

However imperfect, shareholder litigation is an important arrow in the corporate governance quiver.¹²⁰ Shareholders, particularly those of public companies, are necessarily at some distance from management, and the degree of oversight they are able to directly play over corporations is attenuated. Without knowledge with respect to issues decided by the court in a private session, public shareholders are at a distinct disadvantage relative to insiders and managers about governance of the corporation.

Logic dictates that when parties are litigating “bet-the-company” matters, like mergers, which implicate the rights of public shareholders, those public shareholders would benefit directly from having knowledge about the proceeding. If boards of directors are violating their fiduciary duties to the corporation then logic dictates that shareholders, who are often at a distance, be informed of the proceedings so that they might replace incompetent directors.¹²¹ If the sole purpose of confidentiality is to protect incompetent directors from the wrath of unhappy shareholders, then confidentiality does not serve a logically useful function, though convenient for management. Consequently, where the parties include a publicly traded corporation or shareholders without direct representation on the board, they should have no expectation that the results of the arbitration will be kept confidential. Thus, arbitral proceedings conducted by sitting chancellors, especially those that involve shareholders of publicly traded corporations, should

¹¹⁹ “Secrecy is profoundly inimical to this demonstrative purpose of the trial process. Open trials assure the public that procedural rights are respected, and that justice is afforded equally.” *Id.* at 595.

¹²⁰ “This remedy, born of stockholder helplessness, was long the chief regulator of corporate management and has afforded no small incentive to avoid at least grosser forms of betrayal of stockholders’ interests. It is argued, and not without reason, that without it there would be little practical check on such abuses.” *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 548 (1949).

¹²¹ This is consistent with disclosure obligations under the U.S. securities laws.

be presumptively public rather than private affairs, thus justifying a right of access by the public.¹²²

Of course, there may be other situations where the factual nature of the issue in dispute is sensitive, either for business or personal reasons. In such situations, confidentiality might be appropriate. Courts, of course, are no strangers to these kinds of situations. Courts have developed narrowly tailored procedures to issue protective orders when necessary to protect trade secrets or prevent embarrassment. The Delaware courts themselves have regularly demonstrated their ability to safeguard competitive information and other sensitive information. For example, in 2011, the Hewlett-Packard Board was sued by a stockholder pursuant to §220 of the Delaware Code seeking information to support a potential derivative claim against the Board.¹²³ The underlying facts related to an alleged sexual harassment claim against the former CEO. This type of information was highly embarrassing personally to the former CEO, as well as to the alleged victim. The courts in that case were fully capable of keeping these facts out of the record without minimizing the value attributed to exposing the rationale of the court to public scrutiny.¹²⁴ Such orders are narrowly tailored, and balance the parties' interest in confidentiality with the shareholders' and public's interest in information about the companies they own and the current state of the law.

Of course, it is indisputable that federal policy now favors confidential arbitration. Where parties have decided to resolve their disputes in private and in alternate forums, the law will not force them into court. Delaware's response to perceived competition for the adjudication of corporate matters attempts to give disputants the best of all worlds: Delaware's law and judiciary in a confidential setting. In the context of the public company there is no obvious compelling government interest, akin to national security concerns, that might justify keeping otherwise public proceedings confidential. Rather, where shareholders are widely dispersed (Berles-Mean corporation), shareholders have a compelling inter-

¹²² "When [litigants] call on the courts, they must accept the openness that goes with subsidized dispute resolution by public (and publicly accountable) officials. Judicial proceedings are public rather than private property, and the third-party effects that justify the subsidy of the judicial system also justify making records and decisions as open as possible." *Union Oil Co.*, 220 F.3d at 568.

¹²³ *Zucker v. Andreesen*, 2012 WL 2366448 (Del. Ch. 2012).

¹²⁴ A protective order under Rule 26(c) of the Chancery Court's rules can be sought when "justice requires [it] to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense. . ." DEL. CH. R. 26(c).

est in making sure that litigation remains public and accessible to beneficial shareholders. To the extent that disputes involve sensitive commercial or personal information, courts already have procedures to limit the disclosure of such information without shielding the legal issues from public scrutiny. Consequently, Chancery-sponsored arbitration proceedings should be presumptively subject to the qualified First Amendment right of access notwithstanding the name attached to the forum by the Delaware legislature.¹²⁵

V. NETWORKS, EXTERNALITIES, AND ARBITRATION

The market for corporate law and Delaware's peculiar position has long been a focus of study by academics. Professors Cary and Winter first engaged in a debate about the relative effect of state competition for incorporations. On the one hand, Professor Cary argued that when states competed for incorporations, competition would set off a "race to the bottom" with respect to the substantive quality of the corporate law as managers, who controlled re-incorporation decisions opted for states where the substantive rules of the corporate law favored their interests.¹²⁶ Judge Winter observed that managerial decisions necessarily occurred in a capital market in which investors had the ability to punish managerial decisions to reincorporate in jurisdictions that obviously favored management's interests over shareholder interests. In such an environment, one might well expect shareholders to reward states that adopted more shareholder-friendly substantive rules with higher valuations, leading to a potentially virtuous "race to the top" as managers sought out the best substantive rules in order to maximize valuations and minimize the amount of equity required in offerings.¹²⁷

Although the state competition and the race to the top/bottom framework dominated much of the academic thinking about the role of Delaware in the corporate law, later work examined the premise of state competition and found it lacking. To the extent

¹²⁵ "What happens in the halls of government is presumptively public business. Judges deliberate in private but issue public decisions after public arguments based on public records. The political branches of government claim legitimacy by election, judges by reason. Any step that withdraws an element of the judicial process from public view makes the ensuing decision look more like fiat, which requires compelling justification." *Union Oil Co.*, 220 F.3d at 568.

¹²⁶ Cary, *supra* note 6, at 666.

¹²⁷ Winter, *supra* note 6, at 256.

there is any competition at all, it appears to be heavily influenced by a status quo bias in incorporation decisions. Firms tend to incorporate in their home state (i.e. where they have their physical headquarters). Professor Daines examined firms at the IPO stage and found that where firms decided to re-incorporate prior to IPO, they reincorporated almost exclusively in Delaware.¹²⁸ The market for corporate law, to the extent that there is one, is largely a competition between home states and Delaware and not an even playing field upon which all states compete.¹²⁹ In a contemporaneous study, Professor Kahan concluded that the notion of interstate competition for incorporations is largely a myth, at least in recent years.¹³⁰ Other than Delaware, few states generate sufficient revenue from the incorporation business to justify calling the phenomena in the corporate law a market for corporate law.¹³¹ Delaware is an aggressive actor in the corporate law space and the other states have largely ceded the field as a result.

Rather than be a competitive fifty-state market, Professors Roe and Jones have noted the salient competition for Delaware has come from the federal government and the threat of preemption by federal securities laws.¹³² The federal government is likely fully capable of preempting the entirety of the state-based corporate governance apparatus that has developed over the past century. Until now, it has for a variety of reasons opted to leave to the states the question of governing most of the internal affairs of corporations. In some areas, particularly the issuance and the sale of securities, the federal government has stepped in to establish uniform rules to govern the marketplace. The self-imposed limitations on federal intrusion into corporate law are largely arbitrary and the result of politics.¹³³ Consequently, although Delaware now dominates the field of corporate governance, it does so with the federal government always waiting in the wings for a unique combination of political and economic factors that might push it to impose its will on the corporate law.¹³⁴ Against this backdrop, Delaware is constantly engaged in a push-pull relationship with the federal government largely in an effort by Delaware to do just enough to keep

¹²⁸ Daines, *supra* note 7, at 1580.

¹²⁹ *Id.*

¹³⁰ Kahan & Kamar, *supra* note 7, at 748.

¹³¹ *Id.*

¹³² Jones, *supra* note 8, at 660; Roe, *supra* note 8, at 589.

¹³³ Jones, *supra* note 8, at 663; Roe, *supra* note 8, at 590.

¹³⁴ Jones, *supra* note 8, at 661; Roe, *supra* note 8, at 590.

the federal government from reaching out to preempt Delaware's dominant position.¹³⁵

One cannot then clearly explain Delaware's dominance as a question of substantive law. Rather, Delaware's dominance is probably better understood as an economic question. Professors Marcel Kahan and Michael Klausner explain Delaware's dominance as a product of network externalities and path dependence.¹³⁶ The corporate law, according to Professor Klausner, demonstrates many attributes in common with a network. To the extent Delaware is able to sustain its dominant position relative to other states and the federal government, it is due to the positive externalities associated with the Delaware corporate law network. Firms, managers, and others all face economic incentives that push toward Delaware and discourage competition by other states.

A network market is characterized by complementarity and standards, positive externalities, switching costs (i.e. lock-in), and economies of scale in production.¹³⁷ The corporate law is a system of complementarity and standards.¹³⁸ In addition to the corporate code, the Delaware network includes judges and courts specialized in the corporate law, and a deep corporate bar both in and out of Delaware already extremely familiar with Delaware's substantive law.¹³⁹ Delaware judges have taken an aggressive stance toward broadcasting their opinions far and wide in both formal and informal ways. This increased level of interconnectedness increases the degree of compatibility and the likelihood that Delaware law can set the standard for corporate law.¹⁴⁰ The corporate law also demonstrates a degree of positive externalities. Positive externalities exist when the utility gained by relying on the corporate law is a function of the number of other firms also relying on that same system.¹⁴¹ The more ubiquitous the Delaware corporate law, the lower the costs of learning to use it. Professors Kahan and

¹³⁵ Jones, *supra* note 8 at 663; Roe, *supra* note 8, at 644.

¹³⁶ Klausner, *supra* note 17, at 843; Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior, and Cognitive Biases*, 74 WASH. U. L. Q. 347 (1996) [hereinafter Kahan & Klausner I]; Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997) [hereinafter Kahan & Klausner II].

¹³⁷ See OZ SHY, *THE ECONOMICS OF NETWORKS* 1 (2001).

¹³⁸ *Id.* at 2; Nicholas Economides, *The Economics of Networks*, 14 INT.J.IND.ORG. 673, 676 (1996).

¹³⁹ Kahan & Kamar, *supra* note 7, at 759.

¹⁴⁰ Economides, *supra* note 138 (on interconnections and compatibility).

¹⁴¹ *Id.*; SHY, *supra* note 137, at 3.

Klausner liken these externalities to the value boilerplate.¹⁴² With respect to law and legal rules, the costs of learning new rules limit the incentive of firms to re-incorporate in a competing jurisdiction.¹⁴³ Finally, there are significant economies of scale associated with a corporate law network that require significant investments for competitors to overcome.¹⁴⁴

Professors Kahan and Klausner have argued persuasively that corporate contracting, with respect to network externalities, is no different from a host of other markets.¹⁴⁵ Specifically, where parties can adopt a standard term in corporate contracts, there are increasing returns attributable to the common use of the term, notwithstanding the substance of the term.¹⁴⁶ Professor Klausner observes that in the contractarian model of corporate governance, the value of any corporate governance term adopted by a firm is independent of the number of other firms that have already adopted the term.¹⁴⁷ However, if a firm's choice of governance term is influenced by the number of other firms that have previously adopted such a term, then it is possible for the market for corporate law to reach suboptimal standards.¹⁴⁸ That is, where network effects are pervasive, the commonality of any particular term can trump the substance of such a term. The corporate law thus demonstrates network effects.

The market for corporate law and the market for incorporations demonstrate indications of network externalities and competitive strategies consistent with corporate law as a network good.¹⁴⁹ First, the benefits to firms for incorporating in Delaware or adopting standard language in corporate documents are attributable to the lower "learning costs," higher quality and lower cost future legal services, and greater predictability with respect to disputes and dispute resolution.¹⁵⁰ These learning costs all work to reinforce the value of the existing standard and create significant barriers to entry, thus forestalling any potential competition against the established network. Second, the corporate law network has a large

¹⁴² Kahan & Klausner II, *supra* note 136, at 760.

¹⁴³ Economides, *supra* note 138; SHY, *supra* note 137, at 1.

¹⁴⁴ Economides, *supra* note 138; SHY, *supra* note 137, at 5–6.

¹⁴⁵ Kahan & Klausner I, *supra* note 136; *see also* Kahan & Klausner II, *supra* note 136; Klausner, *supra* note 17.

¹⁴⁶ Kahan & Klausner II, *supra* note 136.

¹⁴⁷ Klausner, *supra* note 17, at 761.

¹⁴⁸ *Id.* at 759.

¹⁴⁹ Kahan & Klausner II, *supra* note 136.

¹⁵⁰ Kahan & Klausner I, *supra* note 136, at 352.

“installed base” in the form of Delaware incorporations. While not a first mover in the corporate law, for a variety of reasons in the early twentieth century, Delaware found itself with a dominant position in incorporations.¹⁵¹ More than 50% of all publicly traded firms and more than 60% of Fortune 500 companies are incorporated in Delaware.¹⁵² The dominance in incorporations creates inertia that reinforces the status quo. In addition, the Delaware network has large numbers of complementary services, from lawyers to the Delaware courts. Each of these complements, like Apple’s iTunes store, works to reinforce the incumbent’s position in the network and dissuade competition. Finally, Delaware has aggressively pursued “preemption” strategies by moving quickly to adopt governance reforms in an effort to dissuade potential competitors (e.g. the federal government) from entering the market. For example, recent moves to permit the adoption of majority voting and shareholder access bylaws are intended to convince the U.S. Government that competition in governance is not necessary.¹⁵³ The existence of externalities and switching costs can permit a suboptimal standard to persist for long periods of time.¹⁵⁴ Networks often engage in a series of competitive strategies to support the persistence of the network. All three competitive strategies, first-mover, complementary suppliers, and preemption, can work together to reinforce network lock-in effects and support a dominant network, notwithstanding the presence of theoretically more efficient alternatives.¹⁵⁵

¹⁵¹ See Christopher Grandy, *New Jersey Corporate Chartermongering, 1875-1929*, 49 J. ECON. HIST. 677 (1989).

¹⁵² Jeffrey Bullock, Del. Div. of Corps.: 2011 Annual Report, <http://corp.delaware.gov/2011CorpAR.pdfDel>.

¹⁵³ See, e.g., DEL. CODE ANN. tit. 8, §§ 212-13 (2006) (adopted in response to potential adoption of majority voting and shareholder access rules by the SEC).

¹⁵⁴ Evidence of the persistence of suboptimal standards due to network effects abound. Perhaps the best known is the persistence of the QWERTY keyboard. Notwithstanding the later arrival of a more efficient keyboard, for example the Dvorak keyboard standard, the QWERTY keyboard persists because of high switching costs and lock-in effects. W. Brian Arthur, *Competing Technologies, Increasing Returns, and Lock-In by Historical Events*, 99 ECON. J. 116 (1989); Stanley M. Besen & Joseph Farrell, *Choosing How to Compete: Strategies and Tactics in Standardization*, 8 J. ECON. PERSP. 117 (1994).

¹⁵⁵ In many respects, Delaware’s substantive corporate law is not demonstrably different from the corporate laws of many other states. Indeed, notwithstanding predictions to the contrary, the substantive corporate law of many other states is friendlier to managers than the substantive corporate law of Delaware. For instance, in the area of board responsibilities with respect to unsolicited takeover offers, the Delaware law has developed an approach that is at least circumspect of board actions in response to an unwanted takeover. When a board adopts defensive measures in such situations, before the board can enjoy the benefit of the business judgment presumption, boards will have to satisfy the court that they concluded, after a reasona-

The adoption of the Chancery-sponsored arbitration procedure in 2010 is an example of a preemption strategy. By moving early to establish a formal arbitration regime within the Chancery Court, the clear intent of the Delaware legislature was to dissuade potential competition to Delaware adjudications from developing. In defending the Chancery arbitration procedure before the federal courts, counsel for Delaware, framing the context for competition for adjudications as global, argued that without procedure parties might seek to adjudicate contract disputes before arbitrators outside the United States.¹⁵⁶ In the absence of Chancery arbitration, potential litigants might have an incentive to voluntarily take their disputes out of Delaware. Adoption of the Chancery arbitration procedure was then at least in part an attempt by Delaware legislators to dissuade parties from seeking to adjudicate overseas by way of private arbitration.¹⁵⁷

Adjudications before the Chancery Court are an important complementary component of Delaware's corporate law network. The Chancery Court is well known for its competence in adjudicating business and shareholder disputes. As a result, the Chancery Court and precedent it creates through its decisions play a central function in maintaining the value of Delaware's corporate law network. Arbitration, as it has developed in the past few decades, represents potential competition to this important component of Delaware's network. To the extent policymakers in Delaware see a potential threat to Delaware-based adjudications from future pri-

ble investigation, that some threat existed to the corporation and that the response was reasonable in relation to the threat posed. *Unocal Corp. v. Mesa Petroleum, Co.*, 493 A.2d 946 (Del. 1985). In many states, legislatures have written *Unocal's* "intermediate standard" out of existence. For example, in Massachusetts the corporate law provides in Section 8.30 that a director may benefit from the business judgment rule in similar situations by acting in good faith, with care, and in the best interests of the corporation. Section 8.30 essentially writes out of existence any Massachusetts corollary to Delaware's *Unocal*, and for that matter, *Revlon*. In *The Market for Corporate Law*, Oren Bar-Gill, Michal Barzuza, and Lucien Bebchuk posit a model that suggests Delaware should adopt more manager friendly provisions with respect to takeovers. In fact, Delaware's rules are less manager-friendly than predicted by the authors. See Oren Bar-Gill, Michal Barzuza, & Lucien Bebchuk, *The Market for Corporate Law*, 62 J. INST. & THEO. ECON. 134 (2006).

¹⁵⁶ Del. Bar Ass'n Amicus Brief, *supra* note 71; NASDAQ Amicus Brief, *supra* note 18. See Peg Brickley, *Secrecy Puts Judges on Defense in Delaware*, WALL ST. J. (Feb. 21, 2012), available at wsj.com/article/SB10001424052970204131004577235240702540000.html.

¹⁵⁷ In global transactions, arbitration is often preferable to the courts in part because unlike court judgments, arbitral judgments benefit from the New York Convention, which eases the ability of litigants to enforce awards across jurisdictional boundaries. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Jun. 10 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 (1958).

vate arbitration proceedings, the existence of a Delaware-based alternative to arbitrations may generate an incentive for parties not to exit Delaware in favor of private alternatives.

Thus, the clear objective of the Chancery-sponsored arbitration procedure is to preempt potential development of competition from private arbitration in the market for adjudications. It is worth asking whether the benefit of this preemption strategy to adopt the arbitration procedure and moving cases from the formal docket to the arbitration docket is worth the potential cost to Delaware's franchise over the long term. Here the answer is ambiguous. It is not entirely clear that the Chancery arbitration procedure is materially better than pursuing dispute resolution via the formal, public system. At the same time, there are obvious long-term costs to the value of other aspects of Delaware's network should the arbitration preemption strategy be successful. Given the marginal value of arbitration relative to its costs, the addition of a Chancery arbitration procedure is likely a net negative for Delaware and its corporate law franchise over the long-term.

VI. ASSESSING THE COSTS AND BENEFITS OF ARBITRATION BEFORE THE CHANCERY COURT

Arbitration is often lauded for its many advantages over dispute resolution through the courts. For example, one of the advantages of private arbitration over litigation is said to be speed. Because private arbitration involves a docket of only one, resolution of disputes can be accomplished much faster than when claims must compete for space in the overwhelmed court docket. It is not clear that Chancery arbitration will necessarily be faster than claims heard before the Chancery court in the normal manner. Delaware is already known for its relatively speedy docket. For example, the case of *Martin Marietta, Inc. v. Vulcan Materials Co.*¹⁵⁸ is a typical contract dispute brought before the Chancery Court. The parties in *Vulcan* asked the Court to rule on whether Martin Marietta had breached its duties under a nondisclosure agreement when it made an unsolicited bid for Vulcan.¹⁵⁹ The time between the date of filing of the initial complaint and the issuance of a final order of judgment was just over six months. The time period included a full trial on the merits and an appeal to the Dela-

¹⁵⁸ *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 56 A.3d 1072 (Del. Ch. 2012).

¹⁵⁹ *Id.* at 1077.

ware Supreme Court.¹⁶⁰ Most claims do not get as far as a full trial and appeal. In fact, most claims are settled after the application for a temporary restraining order or a motion to dismiss. In *Vulcan*, that milestone came six weeks after the claim was filed. By any measure, six weeks from filing until disposition of a claim is speedy. By rule, claims brought to the Chancery Court for resolution by arbitration must be set for a preliminary conference on substantive and procedural matters and a hearing must be scheduled within ten days after the petition for arbitration has been received by the court. The arbitration hearing itself must be held on a mutually convenient day within ninety days of filing.¹⁶¹ Though faster than a formal proceeding through final appeal, the arbitration proceeding is not obviously faster for parties than a formal claim through the Chancery Court.

A second supposed advantage of private arbitration is that it permits parties to select an expert in the field to conduct the arbitration. Having a decision-maker with expertise in the substantive area of the dispute helps reduce the time and expense involved in educating the decision-maker. Of course, one of Delaware's long-standing advantages in the adjudication of commercial disputes is the expertise of its specialized judiciary. Since anyone seeking adjudication of a dispute through the Chancery Court would have access to these jurists, the Chancery-sponsored arbitration procedure does not provide any obvious advantage relative to formal adjudication in this respect.

A third advertised advantage of private arbitration is that it grants parties additional flexibility so that they can simplify the dispute resolution process. It is true that the Chancery-sponsored arbitration procedure does not specify any particular process that might constrain the parties, and that the parties are free, with the consent of the arbitrator, to select whatever procedural approach they believe most appropriate to the resolution of their dispute. However, there is no reason to suspect that Delaware judges are hamstrung by their own procedures in a way that makes dispute resolution onerous or time consuming for the parties. Indeed, one criticism of the Chancery Court is that it often resolves issues of fact and law at the motion to dismiss stage, perhaps too early in the process when such cases might be more appropriately resolved at a

¹⁶⁰ See *id.*

¹⁶¹ DEL. CH. R. 97 (2012).

later point in the proceeding.¹⁶² In addition, rulings of a Chancery-sponsored arbitration procedure are subject to appeals to the Delaware Supreme Court. The prospect of an appellate review may impose implicit constraints on the degree of flexibility that a chancellor or the parties may place on the dispute resolution process. A chancellor/arbitrator who suspects that an appeal is possible may feel the need to create a record and justify his rationale for the decision by way of a lengthy opinion to deter (or perhaps facilitate) a later appeal. In the absence of a record or a reasoned opinion, the Supreme Court may be forced to take up appeals *de novo*, building a record and conducting a trial. By any measure, requiring an appellate court to conduct a trial is unusual. However, it might be necessary if parties rely on summary procedures and minimal records. As a consequence, even though the Chancery-sponsored arbitration procedure provides for flexibility, there is reason to suspect that the ultimate process adopted by the court will not diverge a great degree from the Chancery Court's established processes.

The final stated advantage of arbitration over litigation is confidentiality. Indeed, the ability to keep proceedings and outcomes confidential is often cited as a one of the most important advantages of arbitration over litigation. Without confidentiality in arbitration, parties may have important trade secrets revealed or embarrassing details of corporate management heard in the public realm. Similarly, parties may feel they need to adopt confrontational positions in the courtroom that they might not have adopted if they were assured of confidentiality.

It is not clear, however, that confidentiality against these kinds of disclosures by an arbitrator in the Chancery Court is all that valuable. The advantage of confidentiality presumes that courts are somehow unable to prevent the disclosure of information, like valuable trade secrets, which parties might not wish to end up in the public domain. However, courts, including the Chancery Court in Delaware, are capable of using protective orders in order to prevent valuable trade secrets from being revealed into the public domain.¹⁶³ The use of a protective order is a narrowly tailored response to the concern by parties that valuable information might

¹⁶² See, e.g., Comments of Justice Carolyn Berger at Boston College Law School, Apr. 24, 2011 (on file with author).

¹⁶³ Arthur Miller, *Confidentiality, Protective Orders, and Public Access to the Courts*, 105 HARV. L. REV. 428, 464–67 (1991) (providing an overview of the law with respect to protective orders).

end up in the public domain. A protective order permits parties to shield valuable information from inadvertent disclosure and ensures that the court is able to assess the legal issues in the case. The use of narrowly drawn protective orders permits the court to shield parties' valuable information, while exposing the law and legal analysis behind the court's decision to public scrutiny.

Parties may wish to have certain potentially embarrassing behavior or facts related to actions of executives or directors of the corporation shielded from public exposure. Recent experience (e.g. *Zucker v. Andreessen*¹⁶⁴), suggests that courts are capable of relying on protective orders in order to keep the most salacious details out of the public eye.¹⁶⁵ In *Zucker*, a shareholder sued the corporation alleging waste after the board made a large severance payment to Mark Hurd, the former CEO.¹⁶⁶ Mr. Hurd resigned in the wake of a sexual harassment allegation against him.¹⁶⁷ Such allegations were obviously personally embarrassing for those involved. In that case, the Chancery Court was able to keep the most salacious allegations out of the public domain through the use of protective orders without compromising its ability to assess the facts and legal issues and issue a legal opinion that the public could evaluate on its own merits.

However, even if parties believed courts were unable to provide them with sufficient protection for their trade secrets or other information and went to private arbitration to avoid disclosures, there are real limits to a publicly traded firm's ability to keep material information confidential, particularly in cases that one might expect to appear before a chancellor arbitrator. The typical case, at least initially, that a chancellor arbitrator will hear is a merger agreement. In such cases, where the seller is public, the relevant information about the dispute will likely be deemed to be material and must be filed with the SEC. In the case of a merger contract, the results of any arbitration will be material to the shareholders of the seller and will, as a result, have to be disclosed to shareholders. Consequently, there should be no expectation of confidentiality in arbitrations involving mergers or other material agreements. To

¹⁶⁴ *Zucker v. Andreessen*, 2012 WL 2366448 (Del. Ch. 2012).

¹⁶⁵ Miller, *supra* note 163, at 476 (observing that “[t]he protective order is an ideal mechanism for minimizing the negative side effects of modern discovery without eviscerating the value of the process.”).

¹⁶⁶ *Zucker*, 2012 WL 2366448.

¹⁶⁷ Tom Hals & Jim Finkle, *Ex-HP CEO Hurd Fights to Keep Letter Confidential*, REUTERS, Dec. 28, 2010, available at <http://uk.reuters.com/article/2010/12/28/us-hewlettpackard-hurd-law-suit-idUKTRE6BR3GB20101228>.

the extent parties rely on arbitrations, the results of such arbitrations may be disclosed in part to the public but do not become legal precedent. For example, in the Skyworks dispute, the result of that dispute was not confidential. The parties ultimately renegotiated the terms of the agreement with the arbitrator acting as facilitator.¹⁶⁸ If the chancellor arbitrator actually ruled in favor of one party or the other, then the result would have been disclosed by the seller as information, but the ruling itself would not have lived beyond the facts of the claim between Skyworks and AATI.

The direct benefits associated with arbitration before the Chancery Court may be minimal. However, Chancery arbitration proceedings not only pose constitutional challenges, but also pose long-term risks to the value of the Delaware corporate law franchise. To the extent that there are real benefits at all, those benefits appear to be tied to the blanket confidentiality afforded by Chancery arbitration proceedings. This confidentiality is constitutionally troublesome. Confidentiality of the proceedings is also a direct threat to the value and viability of Delaware's corporate law franchise over the long term. The inability of arbitration, even when the results are publicly known, to act as durable precedent may be damaging to the value of that franchise. The observation by U.S. Supreme Court Justice Anthony Kennedy that civil cases have largely left the Court's docket because the Court's preference for arbitration has pushed parties into private resolution of contract disputes is a valuable insight into the potential future impact of a Chancery arbitration procedure on the Delaware franchise.¹⁶⁹ Elsewhere, Professor Jennifer Johnson has observed that since the development of mandatory arbitration with respect to broker-dealer disputes, there has been virtually no development of the law in that area so that all disputes related to broker-dealer issues have been removed from the formal legal system.¹⁷⁰

Consider a thought experiment in which the Chancery arbitration system survives constitutional challenges, or is revived in a manner that comports with constitutional requirements, but maintains the confidentiality of proceedings. What might be the impact over the long term of a Chancery arbitration system?

¹⁶⁸ It is not altogether uncommon for parties seeking to enforce a material adverse change (MAC) clause to use the threat of a MAC clause to renegotiate the merger consideration. See Robert T. Miller, *Canceling the Deal: Two Models of Material Adverse Change Clauses in Business Combination Agreements*, 31 *CARDOZO L. REV.* 99 (2009).

¹⁶⁹ See Skyworks Solutions, Inc., FORM 8-K (Dec. 5, 2011).

¹⁷⁰ Jennifer Johnson, *Critiquing Arbitration of Shareholder Claims*, 36 *SEC. REG. L. J.* 181 (2008).

The first, most obvious, place for a revived Chancery arbitration program to take root is in merger contracts. This is the easiest to envision because merger disputes are no more than contract cases. Contract disputes in other settings are already regularly resolved through arbitration rather than the courts. It does not require much to envision a significant percentage of merger agreements including arbitration provisions. Take, for example, the Skyworks/AATI case where the parties opted into arbitration for resolution of contractual disputes related to the merger agreement. Parties have an incentive to rely on arbitration over formal proceeding if the costs and timing are marginally improved over the normal Chancery proceeding. The parties themselves have little incentive to consider the positive externalities associated with having their dispute resolved through the normal Chancery proceeding. The impact of a significant number of merger-related disputes exiting the formal legal system on Delaware's corporate law franchise will likely be negligible. This is likely true for two reasons. First, the questions before the court in such cases are contract law questions. Delaware judges have never purported to have any special insight into the application of contract law doctrine. Of course, there are circumstances where Delaware judges have decided contract questions as they have arisen in the particular context of a merger transaction (e.g. *IBP Tyson*). However, rarely, if ever, do Delaware judges in such cases claim to be doing more than applying the norms of contract interpretation and contract common law to the facts presented before them.

Indeed, in only a small number of transactions in a sample of merger agreements from 2009-2011 (1%), Delaware courts were asked to interpret New York contract law in the event of a dispute. That is to say, when Delaware courts rule on contract claims, they are often doing so without the ability to set precedent. If Delaware were to exit the stage with respect to merger litigation in favor of confidential, Chancery arbitration might have little or no impact on the development of the contract law beyond the impact on the parties themselves.

A second, and perhaps more concerning question, is the potential impact on the Delaware franchise if provisions requiring Chancery arbitration are included on certificates of incorporation or corporate bylaws. The present position of the SEC staff is that arbitration provisions in corporate charter documents represent il-

legal waivers of the securities laws.¹⁷¹ As a consequence, to date, the SEC has not permitted a firm to go public with such provisions in place. However, arbitration provisions are, in effect, nothing more than forum selection provisions.¹⁷² Rather than select a court of a particular state or jurisdiction, the parties select an arbitration panel for the resolution of disputes. The SEC readily accepts exclusive forum provisions in corporate charters of IPO firms, which permits firms undertaking an IPO to elect to have shareholder litigation be resolved exclusively before the Delaware Chancery Court.¹⁷³ Given the policy established by Congress in the FAA and supported by the U.S. Supreme Court in favor of forum selection provisions and arbitration, it is conceivable that the SEC may eventually extend the flexibility in the selection of the forum to the selection of arbitration in the corporate charters of IPO firms.

Independently, Professor Barbara Black and Paul Weitzel have suggested that successful implementation of arbitration provisions in corporate charter documents could lead to the end of shareholder litigation.¹⁷⁴ Following the U.S. Supreme Court's decision in *AT&T v. Concepcion*, it is conceivable that reliance on arbitration provisions in corporate charters could lead to the end of representative shareholder litigation entirely.¹⁷⁵ In recent years, transaction-related litigation has become, from the point of view of some, an unwelcome part of the deal landscape. Studies suggest that upwards of 80% of merger transactions are now accompanied by litigation, and many mergers are accompanied by multiple lawsuits in more than one forum.¹⁷⁶ If firms are permitted to include mandatory Chancery-sponsored arbitration provisions in corporate charters, reliance on such provisions could force all disputes into

¹⁷¹ Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802 (2009). See also Kevin Roose, *Carlyle Drops Arbitration Clause from I.P.O. Plans*, N.Y. TIMES, Feb. 3, 2012, available at <http://dealbook.nytimes.com/2012/02/03/carlyle-drops-arbitration-clause-from-i-p-o-plans/>.

¹⁷² Barbara Black, *Arbitration of Investors' Claims Against Issuers: An Idea Whose Time Has Come?*, 75 LAW & CONTEMP. PROBS. 107, 112 (2012); Paul D. Weitzel, *The End of Shareholder Litigation? Allowing Shareholders to Customize Enforcement through Arbitration Provisions in Charters and Bylaws*, B.Y.U. L. REV. (forthcoming 2013).

¹⁷³ Quinn, *supra* note 10, at 191 (listing IPO firms with exclusive forum provisions).

¹⁷⁴ Black, *supra* note 172, at 804; Weitzel *supra* note 172.

¹⁷⁵ *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). Admittedly, this is an extreme outcome, but not inconceivable given current attitudes of the court in favor of arbitration. See Miriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of AT&T Mobility v. Concepcion*, 79 U. CHI. L. REV. 623 (2012).

¹⁷⁶ Armour, Black, & Cheffins, *supra* note 10; Cain & Davidoff, *supra* note 10; Quinn, *supra* note 10, at 147.

one forum and strip potential litigants of the right to represent the shareholder class. In that way, Chancery-sponsored arbitration provisions could reduce incentives for entrepreneurial plaintiff counsel from bringing shareholder challenges.¹⁷⁷

The elimination, or at least the corraling, of shareholder litigation would certainly be a dramatic result. Shareholder litigation has been both a savior and the enemy of corporate governance for almost as long as it has existed.¹⁷⁸ Chancery arbitration raises the alluring prospect of on the one hand reducing the problem of shareholder litigation, while on the other assuring that the steady hands of Delaware chancellors maintain control over shareholder disputes. On its face, the elimination of “strike suits” and a streamlining of litigation through the Delaware arbitration procedure appear to be an attractive result. However, the elimination is not without significant costs, which over the long term might threaten Delaware’s corporate law franchise.

Delaware arbitration may well inadvertently reduce lock-in and encourage the development of competition for incorporations where previously such competition did not exist. The existence of switching costs, costs that must be incurred in the event a participant wishes to move away from an existing standard, are an important component of Delaware’s competitiveness. To the extent future shareholder disputes are resolved in Chancery arbitration rather than openly through the courts, Delaware risks degrading the continued maintenance and development of its corporate common law. Such was the experience of contract law development related to broker-dealer disputes following the imposition of mandatory arbitration.¹⁷⁹

The prospect that the arbitration option might become popular with firms, thus leading to a stunting of the development of the corporate law, is a real one. Parties have few incentives to pursue claims in the public system when the costs of such claims are marginally higher than the costs of pursuing claims through arbitration. Plaintiffs are likely going to be indifferent to the positive network effects of their particular claim with respect to the precedent ques-

¹⁷⁷ Quinn, *supra* note 10, at 143–156 (discussing the problem of multi-forum litigation in the context of exclusive forum provisions).

¹⁷⁸ Cohen v. Beneficial Indus. Corp., 337 U.S. at 541, 548 (1949). (“This remedy, born of stockholder helplessness, was long the chief regulator of corporate management and has afforded no small incentive to avoid at least grosser forms of betrayal of stockholders’ interests. It is argued, and not without reason, that without it there would be little practical check on such abuses.”).

¹⁷⁹ Black, *supra* note 172, at 830.

tion. The generation of precedent for subsequent litigants does not enter into the equation for determining whether or not to pursue arbitration versus litigation unless the parties are serial litigants before the court.¹⁸⁰ Parties who will benefit from the generation of new precedent are future litigants. Parties, particularly firms, thus have no incentive to pursue claims in the public system for the purpose of generating precedent.¹⁸¹ Litigants with “future stakes” have no ability to influence the decisions of present litigants with respect to their decision to pursue arbitration.¹⁸²

The presence of a thick corporate common law that is regularly updated is central to the continued viability of Delaware’s corporate law franchise. Practitioners, including lawyers, have invested significant resources in mastering the corporate common law. This investment represents switching costs that lock market participants into the Delaware network. As parties shift to confidential arbitration, the value of those investments will decline. Rather than look to the common law as developed through the large number of opinions crafted by the Delaware chancellors every year and reported through publicly accessible databases, practitioners seeking to learn the current state of the corporate law will have to invest resources into unorthodox sources in order to maintain a sense of the pulse of the current state of corporate law. Rather than publicly available databases of court opinions, practitioners will be required to rely on personal relationships with judges and members of the Delaware bar to learn the current state of the law. This is a high-cost strategy that immediately excludes large numbers of practitioners who lack access to the inner circle of Wilmington. The closed network of arbitration makes transactional planning difficult without advice of Delaware counsel, whereas previously parties could rely on New York or other counsel who simply looked at the record. With arbitration, knowledge of the current state of the law is reduced only to Delaware litigators who appear before arbitral bodies. Rather than benefit from an open network, the arbitration path creates a closed network with high costs for participation.

The high cost of this closed network approach to the corporate law reduces incentives for lawyers to stay in Delaware and creates opportunities for potential competition where previously there were none. From the point of view of opportunistic states or the

¹⁸⁰ See Landes & Posner, *supra* note 16, at 236.

¹⁸¹ *Id.*

¹⁸² *Id.*

federal government seeking to compete with Delaware, a shift into Chancery arbitration provides an opportunity for a relatively small investment in other jurisdictions to lure firms and their lawyers away from Delaware and toward an alternative regime that might require little or no additional investment to learn a new standard. Perhaps more correctly, by raising the costs of learning the current state of the law, lawyers have an incentive to counsel localization of the corporate law over staying with the Delaware standard.

In a world of shareholder arbitration and confidential rulings, the Delaware judiciary could attempt to stem the negative consequences of confidentiality on its jurisprudence. Already, Delaware judges play an active role in the profession. They are frequent speakers at law schools and at conferences of business lawyers. They engage the academy through regular contributions to law reviews and symposia. Continued active involvement with the profession beyond a small circle, however, is not costless. Such a strategy takes time and resources that compete with the primary occupation of the judiciary of dispute resolution. In addition, while treatise writing and more engagement with the profession may be sufficient to maintain at least a general sense of the corporate law, they may not be sufficient or timely for practitioners counseling clients.¹⁸³

Although there are no states actively competing with Delaware for incorporations presently, it is by no means assured that Delaware will maintain its preeminent position, or that given the right opportunity, other states will not seek to compete again for incorporations. For its part, after New Jersey faltered and passed restrictions on corporations at the insistence of then-Governor Wilson in 1913, Delaware vaulted past New Jersey in the competition for incorporations.¹⁸⁴ There is no reason why Delaware cannot also pursue a policy-based “own goal” in the form of Chancery arbitration. To the extent arbitration removes important cases from the public courts, it reduces the value of Delaware’s network. As the value of the network declines over time, the switching costs

¹⁸³ See Frank Partnoy, *Synthetic Common Law*, 53 U. KAN. L. REV. 281 (2005) (describing the development of a version of a “synthetic common law” from arbitration claims).

¹⁸⁴ This kind of opportunistic movement is not dissimilar from how Delaware was able to take advantage of misplays by New Jersey and essentially co-opt all of the New Jersey firms at the time. Delaware’s predominance, it is worth remembering, was not initially a product of efficiency so much as it was a product of New Jersey Governor Woodrow Wilson’s overreach. Delaware adopted New Jersey’s corporation law in its entirety and, following Governor Wilson’s decision to impose anti-trust constraints on firms incorporated in New Jersey, firms moved en masse to neighboring Delaware. See Grandy, *supra* note 151.

that lock in many practitioners may also decline and thus increase the incentive for states to reengage in competition for incorporations.¹⁸⁵

More generally, Chancery arbitration raises a normative question: whether it is better for firms to resolve shareholder disputes out of the public eye through private arbitration procedures. The answer requires some subtlety. The U.S. Supreme Court and the Congress, through the FAA, have indicated a policy in favor of arbitration. The policy is based in part on the reasonable belief that the parties to the contract themselves are in the best position to determine the most cost effective and efficient forum for the resolution of their disputes. Where this is the case, there is no reason to require parties to bring disputes through the formal mechanism.

With respect to disputes over the merger contracts, there is no reason to believe *ex ante* that contracts are best adjudicated in a public forum. Where parties have equal bargaining power and are represented by experienced counsel, one might well be agnostic regarding the question of whether parties agree to resolve disputes through formal mechanisms or through arbitration. In that respect, merger agreements are the opposite of consumer contracts and contracts of adhesion. They are heavily negotiated and legal counsel is heavily engaged in the process. In addition, the doctrinal issues that often array themselves in contract disputes are not necessarily new or original and can safely be resolved by an arbitrator rather than a judge. Consequently, the initial thought might be that, in mergers, parties should be free to arbitrate.

However, where arbitration involves shareholder litigation, the contractual arguments in favor of arbitration become less compelling. First, to the extent the results of shareholder arbitration are akin to representative litigation, one may have reason to be concerned that confidential arbitration makes it difficult for shareholders who are not directly represented before the arbitrator to be confident in the quality of the outcome. Shareholder litigation is already itself a remedy apt for abuse.¹⁸⁶ Subsequent to the U.S. Supreme Court's decision in *AT&T v. Conception*, shareholder arbitration may be even less likely to instill confidence in the ability

¹⁸⁵ New York appears to recognize the importance of increasing the value of the New York commercial common law network. In the Task Force's report to the Chief Judge, the Task Force recommended increasing the visibility of the commercial court's jurisprudence through the establishment of a free, text-searchable database of court opinions from the Commercial Division. TASK FORCE, *supra* note 56, at 13. See Coyle, *supra* note 55, at 1923 (noting that nineteen states have developed specialized business courts).

¹⁸⁶ See *Cohen*, 337 U.S. at 548.

of confidential arbitration to guarantee the rights of shareholders who are not before the arbitrator.¹⁸⁷ If firms were to begin to adopt Chancery arbitration provisions as part of their incorporation documents, it is conceivable that firms might also restrict the ability of shareholders to bring shareholder class action claims or other forms of representative shareholder litigation.¹⁸⁸ In that way, Chancery arbitration could spell the end of shareholder litigation altogether. This is concededly an extreme result, but it is possible. No doubt given the current state of transaction-related litigation, it may be preferred by many.

To the extent representative shareholder arbitration continues, the representative nature of shareholder dispute resolution requires at the very least, widespread distribution of information with respect to the content of the litigation that makes the confidential nature of Chancery arbitration unworkable. Without widespread distribution of information about the litigation, shareholders who are not directly represented may lose confidence in the ability of the dispute resolution process to adequately and fairly represent the interests of all shareholders. To the extent confidentiality of the proceedings is central to the value of Chancery arbitration, this may be in conflict with the requirements of fairness.

In addition, shareholders have certain statutory disclosure rights. In the event of litigation consequent to a merger agreement, shareholders have the right to make an informed vote whether to approve the merger agreement. Where there is transaction-related arbitration, shareholders have a statutory right to know the result of the arbitration before they cast their vote. If the result of arbitration is clothed in confidentiality, then shareholders may not have material information required in order to appropriately approve a merger agreement. Arbitration, therefore, may be inconsistent with shareholders' statutory rights to information where that arbitration is related to a proposed transaction.

Where there is shareholder arbitration outside the context of a merger agreement, shareholders may also have rights to disclosure under the both corporate and securities laws. The securities laws require the disclosure of material information to shareholders. Corporate laws also have a similar duty of disclosure that may

¹⁸⁷ *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. at 1740 (2011) (holding that states are prohibited from conditioning the enforceability of certain arbitration agreements on the availability of class-wide arbitration procedures).

¹⁸⁸ Professor Black recognized this possibility early on. See Black, *supra* note 172.

make it difficult for firms to rely on confidential arbitration to conceal management misdeeds. This will be especially true when the questions before the arbitrator relate to the failure of managers of the corporation to comply with their fiduciary duties to the corporation. Without access to the results of litigation, shareholders may find it difficult to uncover managerial improprieties. The importance of shareholder litigation, however imperfect, in uncovering and thus constraining potential management overreach is an ample enough reason to conclude that shareholder litigation is best undertaken in the full light of day, even if those closed proceedings are before a Delaware chancellor, rather than before closed-door arbitration proceedings.

VII. CONCLUSION

In implementing Chancery-sponsored arbitration, proponents may think they are making the best of a bad, long-term situation. Delaware policymakers fear the rise of private arbitration as a competitor with Delaware in the market for the adjudication of corporate disputes. The creation of an arbitration forum before Delaware chancellors is an attempt to preempt the development of private arbitration for merger agreements and shareholder litigation and, in that way, maintain Delaware's market position. However, leaving aside the questions of constitutionality of the proceedings, the effort to preempt the development of private arbitration may simply prove too much.

First, there is not much evidence to support the contention that parties are presently seeking to bring merger disputes or shareholder disputes to forums other than Delaware. There is even less evidence to support a contention that Delaware faces competition for adjudications from international forums. Second, if Delaware is successful in promoting its Chancery arbitration, there is reason to suspect that a significant amount of shareholder litigation would be converted over time to Chancery arbitration as managers seek ways to mitigate the problem of "strike suits." The result may be to erode the value of Delaware's corporate law franchise and thus reduce barriers to competition.

Until now, other states have been content to sit on the incorporation competition sidelines. However, if increasingly more shareholder litigation is resolved as arbitration, the barriers to entry in the market for incorporations may decrease over time. With

lower barriers to entry, lawyers may find it cheaper and easier to counsel their clients to incorporate in alternate jurisdictions, thus enticing new entrants into what was a dormant market. In that way, Chancery arbitration may prove to be an “own goal” that places Delaware’s position with respect to its corporate franchise in jeopardy. Given the state’s interest in maintaining its position, Delaware may be better served by abandoning the Chancery-sponsored arbitration system altogether and finding a way to live in peace with the prospect of private arbitration.

