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Expert Determination or Arbitration? The Delaware Court of Chancery Clarifies That Labels Are Not Dispositive

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Purchase agreements customarily contain provisions for resolving certain disputes by referring them to a third-party neutral decision-maker outside of litigation. For example, disputes over purchase price adjustments are often referred to an independent accountant to resolve the parties' disagreements regarding accounting methodology and calculations.

Whether such a dispute resolution process is an arbitration or expert determination has several significant implications. One key difference is that arbitrators generally have plenary authority to decide all legal and factual issues necessary to resolve a dispute, including by interpreting the purchase agreement, whereas experts are limited to deciding specific factual disputes within their area of expertise and interpreting the relevant contract only to the extent necessary to decide such factual disputes.[1] Another difference is the standard of review that applies to actions seeking to challenge the decisions of arbitrators as opposed to experts.

Therefore, parties often end up litigating as a threshold matter whether their purchase agreement's dispute resolution process is an expert determination or an arbitration. The answer informs whether certain issues are to be decided through the purchase agreement's dispute resolution mechanism or by a court, and whether the agreement's dispute resolution process can be compelled under the Federal Arbitration Act (FAA) or a state law analog.

In two recent decisions, the Delaware Court of Chancery clarified that merely referring to a decision-maker as an "arbitrator" and its decision as an "arbitral award" is insufficient to make the dispute resolution process an arbitration and, conversely, referring to the decision-maker as an "expert" without more is insufficient to make the dispute resolution process an expert determination.[2] Instead, the dispute resolution process itself must be considered holistically to determine whether the provision has the hallmarks of an arbitration or expert determination.

Background

In *ArchKey Intermediate Holdings Inc. v. Mona*, the plaintiff purchaser acquired an electrical contractor (seller) through a stock purchase agreement (SPA). The SPA provided for an adjustment to the purchase price based on the difference between an estimated closing balance sheet and an adjusted closing balance sheet (the Adjusted

Closing Balance Sheet) prepared by the purchaser post-closing. The SPA required the purchaser to prepare the Adjusted Closing Balance Sheet "in good faith and in accordance with generally accepted accounting principles (GAAP) and consistent with the past practices" of the company.[3] If the seller failed to provide an objection notice (the Objection Notice) within 30 days after its receipt, the Adjusted Closing Balance Sheet would be deemed final. If the parties were unable to resolve any dispute regarding the Adjusted Closing Balance Sheet, the SPA required them to submit their disputes to an "independent accountant" who "shall act as an arbitrator."[4] According to the SPA, the independent accountant's determination "shall be final, binding, conclusive and non-appealable" absent "manifest error."[5]

Post-closing, the purchaser delivered an Adjusted Closing Balance Sheet that resulted in more than a $12.6 million purchase price reduction, which represented more than a 50% reduction to the negotiated purchase price. The seller objected. Unable to resolve their disputes, the purchaser filed suit in the Delaware Court of Chancery seeking an order compelling the seller to pay the $12.6 million reduction to the purchase price. The purchaser further claimed that the seller waived any objections to the Adjusted Closing Balance Sheet because it failed to provide its objections within the 30-day period provided by the SPA.

In response, the seller asserted counterclaims of his own for breach of contract, claiming that the purchaser did not prepare the Adjusted Closing Balance Sheet in good faith and asserting that its Objection Notice was timely. After the pleadings closed, the purchaser moved for judgment on the pleadings and, in the alternative, moved to compel arbitration pursuant to the SPA's purchase price adjustment provision. The purchaser argued that the SPA provided for arbitration of the parties' disputes about the Adjusted Closing Balance Sheet and, therefore, all the seller's arguments about whether its Objection Notice was timely and whether the Adjusted Closing Balance Sheet was prepared in good faith, in accordance with GAAP, and consistent with past accounting practices, were issues for the arbitrator. The seller opposed the motion to compel, arguing that the SPA's dispute resolution process was an expert determination despite the SPA's language that the "independent accountant shall act as an arbitrator." [6] A threshold issue for the court in *Archkey*, therefore, was whether the SPA's dispute resolution process was an expert determination or an arbitration.

In *ArchKey*, the court found that the SPA's dispute resolution provision "plainly contemplates an expert determination" notwithstanding its language that the independent accountant "shall act as an arbitrator."[7] In reaching its decision, the court explained that Delaware has adopted the authority test — the analytical framework proposed by the New York City Bar Committee on International Commercial Disputes.[8] The authority test "turns primarily on the degree of authority delegated to the decision-maker" and "compares the features of the parties' ADR mechanism with the avatars of a legal arbitration and an expert determination."[9] Although using words like "arbitrator" or "arbitration" provides a "signal" about the parties' intent, those words are not dispositive.[10] What matters is the authority granted to the decision-maker, and whether that authority "more closely resembles the broad authority conferred on a legal arbitrator, who can decide the entirety of the controversy and award final relief, or whether the grant is narrower and involves more fact-like determinations."[11]

The court found that the SPA's dispute resolution provision only granted the independent accountant the authority to resolve disputed matters identified in the seller's Objection Notice and not to resolve the parties' disputes more generally. The SPA stated "[i]f, at the conclusion of the Resolution Period, Purchaser and Seller have not reached an agreement with respect to all disputed matters contained in the Objection Notice, then within ten (10) Business Days thereafter, Purchaser and Seller shall submit those matters remaining in dispute to the Independent

Accountant for resolution."[12] The court held that this narrow scope of authority is consistent with an expert determination, and not with legal arbitration. Moreover, that the SPA explicitly permitted court resolution of other issues unrelated to the Adjusted Closing Balance Sheet, further supported that the dispute resolution process was an expert determination.

The court identified additional secondary evidence that the process was an expert determination and not an arbitration. The SPA's dispute resolution provision stated:

The Independent Accountant shall act as an arbitrator to resolve (based solely on the written presentations of Purchaser and Seller and not by independent review) only those matters submitted to it…, and shall render a resolution of all such disputed matters within thirty (30) days after its engagement…The Independent Accountant shall set forth its conclusions in a written statement delivered to Purchaser and Seller and shall be final, binding, conclusive and non-appealable for all purposes hereunder, other than manifest error.[13]

First, the choice of an "independent accountant" as the decision-maker evidences the parties' intent to rely on the independent accountant's subject matter expertise, which is consistent with an expert determination, not a legal arbitration. Second, the dispute resolution provision does not reference or incorporate a set of arbitral rules or an arbitral organization. This too is more consistent with an expert determination than arbitration. Third, the SPA did not provide for a hearing, whereas a legal arbitration involves hearings at which evidence is presented. Fourth, the SPA's dispute resolution procedure provided "manifest error" as the standard of review, which is not a statutory basis for review of an arbitration award under the FAA.

Thus, the court concluded that the SPA's dispute resolution process was a "run-of-the-mill Accountant True-Up Mechanism," routinely included in purchase agreements to resolve disputes about amounts included in financial statements or schedules.[14] Accountant True-Up Mechanisms generally are too far removed from legal arbitrations and, therefore, are expert determinations regardless of whether the purchase agreement refers to the accountant as an arbitrator or the decision as an arbitration award. The court stated that "[t]o shift an Accountant True-Up Mechanism into the arbitral side of the spectrum, the provision needs to do more, such as by specifying a sponsoring arbitral organization and designating a set of arbitral rules. Without additional signals, an Accountant True-Up Mechanism is a beefed-up expert determination, not a slimmed down legal arbitration."[15]

Because the process was an expert determination, the court held that the independent accountant did not have authority to decide all factual and legal issues needed to fully resolve the parties' disputes, including whether the seller's Objection Notice was timely, whether there was a breach of contract, or whether the purchaser's preparation of the Adjusted Closing Balance Sheet breached the implied covenant of good faith and fair dealing. Conversely, the independent accountant had authority to decide only those disputes within its expertise that the parties delegated to it, such as, whether the purchaser prepared the Adjusted Closing Balance Sheet consistent with GAAP and the seller's past accounting practices and whether the purchaser made the accounting adjustments in good faith. After concluding that the seller did not waive its objections to the Adjusted Closing Balance Sheet, the court ruled that the parties present these issues within the independent accountant's authority for expert determination and stayed the case. The court stated that it would address any legal issues that remained after the expert determination, taking into account the independent accountant's determinations.

In *Cedres v. Geoffrey Servs. Corp.*, the Delaware Court of Chancery similarly decided whether a settlement's

agreement's alternative dispute resolution (ADR) provision called "for an arbitration or expert determination."[16] In *Cedres*, the ADR provision stated that the decision-maker "shall be functioning as an expert and not an arbitrator."[17] The court, however, applied the authority test and ruled the provision provided for arbitration. The provision specified that "all issues and disputes" regarding the parties' payment obligations were to be sent to an "Independent Party" for resolution.[18] The provision further stated that:

the Independent Party shall make a final and binding determination with respect to (i) *the legal obligations* of the Parties to make Payment Obligations as claimed in the Claim Documents, (ii) the amounts of such payment Obligations remaining due and unpaid as of the date of such determination, and (iii) the *entitlement of any Parties to the recovery of legal fees and court and litigation costs associated with the Action and/or the Transaction Documents and the amounts due as a result* (collectively, the Matters in Controversy).[19]

The court held that the first and third determinations "required the Independent Party to make judicial determinations of legal obligations and the prevailing party, 'not just of the proceedings before the Independent Party but the entire litigation.'"[20] Therefore, the authority granted to the decision-maker more resembled an arbitration than an expert determination.

The court further noted that the ADR Provision incorporated by reference a set of guidelines for the Independent Party to use to "analyze and resolve the Parties' dispute" that resembled the traditional hallmarks of an arbitration.[21] More specifically, the ADR provision provided for (i) conference calls between the parties and the Independent Party; (ii) independent, *ex parte* calls with the Independent Party; (iii) initial written submissions and evidence in support of the parties' positions; and (iv) memoranda responding to the evidence submitted by the opposing party.[22]

The court found that "[t]hese guidelines create the look and feel of a judicial proceeding."[23] Therefore, despite the parties' explicit agreement that the Independent Party was to "function[] as an expert and not an arbitrator," the court ruled that the ADR provision called for an arbitration.[24]

Takeaways

The *ArchKey* and *Cedres* decisions confirm two important points when drafting purchase agreements. First, understand the differences between the various types of dispute resolution and choose the one that best accomplishes your objectives. Second, understand how to structure the purchase agreement's resolution process to achieve your objectives and how a court will interpret those provisions. Merely calling a process an expert determination or arbitration is not sufficient to define it as such. Rather, the court will look at the provision holistically to determine whether it is an expert determination or arbitration.

Factors that weigh in favor of the provision being an expert determination include:

- The dispute relates to a specific factual issue concerning a specialized area of expertise, such as a valuation or accounting issue.
- The dispute is referred to a subject-matter expert, such as an accountant or appraiser, for resolution.
- The dispute resolution provision does not reference or incorporate a set of arbitral rules or an arbitral

organization.

- The dispute resolution provision does not provide for a hearing or the taking of evidence.
- The decision by the third party is final and binding upon the parties and there is no express right to appeal or challenge that decision.

Factors that weigh in favor of the provisions being an arbitration include:

- The arbitrator is an individual or panel of individuals who are usually legal professionals, such as retired judges, practicing attorneys, or law professors.
- The arbitration is conducted under the ambit of a sponsoring organization, such as the AAA or JAMS ADR.
- The arbitration proceeds using an established set of procedural rules, often promulgated by the sponsoring organization, such as AAA rule or JAMS ADR rules.
- The arbitrator takes evidence and hears testimony.
- The arbitrator issues an award, enforceable in the same manner as a court judgment.
- The arbitrator has immunity from suit, as would a judicial officer.
- The arbitrator's decision is subject to appeal, albeit under a standard that is highly deferential to the arbitral award.
- The proceeding is governed by the FAA or a state-law statutory counterpart.

Practitioners should consider and adopt these factors to achieve their client's desired result when drafting their dispute resolution provisions in purchase agreements.

[1] *Penton Bus. Media Holdings, LLC v. Informa PLC*, 252 A.3d 445, 464 (Del. Ch.), judgment entered, (Del. Ch. 2018); *Paul v. Rockpoint Grp., LLC*, No. 2018-0907-JTL, 2024 WL 89643, at *9-10 (Del. Ch. Jan. 9, 2024).

[2] *ArchKey Intermediate Holdings Inc. v. Mona*, 302 A.3d 975, 995 (Del. Ch. 2023); *Cedres v. Geoffrey Servs. Corp.*, No. 2020-0745-MTZ, 2024 WL 1435110, at *2-3 (Del. Ch. Apr. 3, 2024).

[3] *Id*. at *984.

[4] *Id*. at *985.

[5] *Id*. at *996.

[6] *Id*. at *985.

[7] *Id*. at *995.

[8] *See Terrell v. Kiromic Biopharma, Inc.*, 297 A.3d 610 (Del. 2023).

[9] *ArchKey Intermediate Holdings Inc.*, 302 A.3d at 993 (citing *Penton*, 252 A.3d at 458).

[10] *Id*. at 993.

[11] *Id*. at *995.

[12] *Id*.

[13] *Id*. at *995-96.

[14] *Id*. at *992.

[15] *Id*. at *995.

[16] 2024 WL 1435110, at *1.

[17] *Id*. at *3.

[18] *Id*. at *1.

[19] *Id*. at *3 (emphasis added).

[20] *Id*. at *4.

[21] *Id*.

[22] *Id*.

[23] *Id*.

[24] *Id*.

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