Should Venture Capitalists Choose Court Or Arbitration?

Stuart Gasner, Partner Keker & Van Nest
September 2013

In drafting agreements, venture capitalists and their lawyers usually have to choose some form of dispute resolution in that "Miscellaneous" or "Other Provisions" section of the agreement. It seems like a trivial paragraph compared to the more heavily negotiated parts of the agreement. But it's the first thing I look at when clients come to me with a dispute. And despite its importance to trial lawyers, the dispute resolution provision often gets short shrift from transactional lawyers, who oftentimes have a "standard" provision that they include in every agreement and that never gets tested in litigation.

Before you can decide what type of dispute resolution is best for your agreement, you need to understand the many options you have. Your first decision is your preferred *location*. In most business cases, that's going to be either your hometown (because it's convenient and your company is likely to have a slight home court advantage over out-of-towners) or Delaware (because it has a well-developed body of corporate law and assuming it is your company's place of incorporation). Delaware Chancery Court, for example, is a wonderful place to try complicated business cases in front of smart and decisive judges (as long as you have some form of equitable relief at stake). While venue selection clauses with unusual locations can get disputed in court, an arbitration can be just about anywhere, although most arbitrations end up in the home town of the party with more bargaining power.

Your next choice is what *decision making system* you prefer. For court, the choice is between the state and the federal judicial systems. The differences between the two vary considerably across the United States, and there are good and bad judges in both, but most lawyers will have strong opinions about the differences in their jurisdiction (which is why you need to choose "where" first). If you put a hundred trial lawyers under hypnosis, I suspect that most of them would say that the federal system offers a better experience for business litigants, but it's a closer call if, for example, you compare the state judges in the complex litigation department in California to their federal counterparts. A lot depends on whether you prefer fast or slow; the court funding crisis in California has made state court slow indeed. For arbitrations, the choice is typically between the Judicial Arbitration and Mediation Service ("JAMS"), the American Arbitration Association ("AAA"), or one of the international arbitration organizations such as the International Chamber of Commerce. JAMs has in recent years attracted many former superstars of the bench, and tends to be the pick for complex, high stakes matters; AAA tends to be the provider of choice where more routine matters are expected to be in dispute.

Finally, you have options as to *how* your dispute will be adjudicated. In court, the options are a bit limited, with a waiver of jury trial being one of the few ways you can override normal procedure. In arbitration, the options are pretty much unlimited. You can specify the number of arbitrators (usually one or three), their qualifications (but keep in mind that unconflicted people with "more than 10 years of experience in exactly your field" can end up a null set), how the arbitrators are selected, how much discovery can be conducted (ranging from no depositions to many more than would be allowed in most courts), time limits on discovery and length of the hearing, time limits on how quickly the hearing must held, and on and on.

So what's best for your situation? The answer is a resounding "it depends." The key is to visualize what the likely disputes are going to be, and which combination of characteristics is more likely going to favor your side. If you expect the possibility of large, high-stakes disputes in which you may need to move quickly or need prompt and decisive early action, you'll probably be better off in court … or at least make sure your arbitration clause includes an exception for injunctive relief. Arbitrators often come from an "alternative dispute resolution" background and are naturally inclined towards compromise. And arbitration rules are often biased in favor of a hearing and do not even allow for motions practice, except at the discretion of the arbitrator. Court is also the place to be if you think a jury is going to be sympathetic to your side of the case. And judges and juries are provided courtesy of your tax dollars, while the decision-makers in arbitrations often charge tens of thousands of dollars a day.

If, on the other hand, you think that the disputes are likely to be highly technical, or compromise is a good thing, or you have a very specific idea of how your dispute ought to be resolved (my daydream is of a world in which everything is decided by "baseball" arbitration in which the arbitrator has to pick one of two resolutions proposed by the parties), then you'll be inclined towards arbitration.

Save a little energy at the end of your next negotiation for some serious thought about what disputes are likely to arise under the agreement, and what mechanism for resolution would favor your side of the debate. Your trial lawyers will thank you down the line.

Stuart Gasner is a Partner at Keker & Van Nest LLP, sgasner@kvn.com

Stuart Gasner is a Partner at Keker & Van Nest LLP in San Francisco where he centers his practice in the areas of white collar criminal and securities defense, intellectual property litigation and complex corporate disputes. His clients include venture capital firms and their portfolio companies, investment partnerships, and companies in industries ranging from biotechnology to semiconductors. He can be reached at sgasner@kvn.com and (415) 676-2209.

Keker & Van Nest LLP

For more than thirty years, Keker & Van Nest (www.kvn.com) has litigated complex, high-stakes civil and criminal cases throughout the nation. KVN takes the make or break cases where companies, products, careers and reputations are riding on the result.