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IN PRACTICE

ALTERNATIVE DISPUTE

Material Effect on Arbitration Of Commercial Disputes

Be mindful of *Life Receivables* holding when litigating in New York

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New Jersey practitioners who arbitrate commercial disputes need to be aware of a recent decision by the Second Circuit which materially affects how those disputes are litigated. In *Life Receivables Trust v. Syndicate 102 at Lloyd's of London,* 549 F. 3d 210 (2d Cir. 2008), the Second Circuit held that Section 7 of the Federal Arbitration Act, 9 U.S.C.A. § 7 (2008), does not authorize arbitrators to issue pre-hearing document subpoenas to non-parties, joining the Third Circuit in so concluding (*Hay Group, Inc. v. E.B.S. Acquisition Corp.,* 360 F. 3d 404 (3d Cir. 2004)). Under *Life Receivables*, a non-party can be compelled to produce documents only where he is being called to testify at the arbitration hearing ("merits hearing") or a preliminary hearing. Where the non-party declines to produce documents before the merits hearing, and no preliminary hearing is conducted, an arbitration party must rely on state law to obtain the documents before the hearing, showing both that the FAA is inapplicable and a special need for the discovery. *Life Receivables* is significant for New Jersey counsel because New York is frequently where commercial disputes involving New Jersey residents and corporations' New Jersey offices are arbitrated. For example, securities arbitrations involving customers and brokerage firm branch offices located in northern New Jersey are arbitrated before FINRA Dispute Resolution's New York offices. Thus, New Jersey counsel will likely have to consider the impact of *Life Receivables* on his ability to obtain non-party discovery for use in arbitration.

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The Second Circuit's Decision

In *Life Receivables,* plaintiff Life Settlements Corp. purchased on behalf of a related trust life insurance policies from the daughter of Wang, the named insured. As a hedge against the possibility of Wang living past his projected life expectancy, plaintiff purchased for the trust a contingent cost insurance policy from defendant Syndicate 102 at Lloyd's of London. This policy required that all disputes be arbitrated under the rules of the American Arbitration Association. The trust initiated arbitration against defendant when defendant refused to pay it the net death benefit under the Wang policies. In the arbitration, the arbitrators at defendant's request issued a pre-hearing subpoena requiring plaintiff, which was a party to the arbitration agreement but not the arbitration, to produce documents. Plaintiff filed suit to quash the subpoena, arguing that the arbitrators lacked authority to compel pre-hearing discovery from a non-party. The district court denied plaintiff's application, holding that there was "no reason to disturb the arbitration panel's issuance of such a subpoena to an entity that, while not a party to the specific arbitration at issue, is a party to the arbitration agreement."

The Second Circuit reversed, finding that the FAA did not authorize the arbitrators to issue pre-hearing discovery subpoenas. The court focused on the language of Section 7 of the statute, providing in relevant part:

> The arbitrators selected …, or a majority of them, may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case.

Finding this language "straightforward and unambiguous," the court held that "documents are only discov-

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erable in arbitration when brought before arbitrators by a testifying witness." Pre-hearing discovery in civil litigation was generally not permitted when the FAA was enacted in 1925; consequently, "the fact that the Federal Rules of Civil Procedure were since enacted and subsequently broadened demonstrates that if Congress wants to expand arbitral subpoena authority, it is fully capable of doing so." Acknowledging that "[t]here may be valid reasons to empower arbitrators to subpoena documents from third parties," the court nonetheless concluded that it had to interpret the statute "as it is, not as it might be, since 'courts must presume that a legislature says in a statute what it means and means in a statute what it says….'" Thus, Section 7 "does not authorize arbitrators to compel pre-hearing document discovery from [non-parties];" such entities can be compelled to provide documents only where they are "produced by a witness at a hearing before the arbitrators."

The court rejected defendant's argument that the subpoena should be enforced because plaintiff is "intimately related" to the trust, concluding that "Section 7 contains no discovery exceptions for closely related entities." Further, the Section 7 subpoena power is not restricted to parties, as it encompasses "any person" that the arbitrators decide to bring before them; instead, the statutory limitation "is expressed in terms of the method and timing of the subpoena," i.e., "[t]he documents must be produced by a witness at a hearing before the arbitrators."

The court likewise rejected defendant's alternative argument that Section 7 authorizes arbitrators to subpoena documents from entities that are parties to the arbitration agreement if not the arbitration itself, observing that "although Section 7 does not distinguish between parties and non-parties to the actual arbitration proceeding, an arbitrator's power over parties stems from the arbitration agreement, not Section 7" and that where such agreement so provides, the arbitrator's authority "includes the power to order discovery from the partie." By contrast, "arbitrators have no such power to compel discovery from third parties — even those (like plaintiff) that signed the underlying arbitration agreements." Consequently, arbitrators relying on Section 7 to compel discovery from non-parties "must do so according to its plain text, which requires that documents be produced by a testifying witness."

Conduct of Non-Party Discovery in Arbitration

While *Life Receivables* forecloses reliance on the FAA as a basis for subpoenaing pre-hearing discovery, the decision is not a complete bar on a party obtaining such documents before the hearing. For example, a non-party subpoenaed to produce documents and testify at the hearing might choose to comply with the subpoena and produce the documents before the hearing, as the "inconvenience of making a personal appearance may cause the testifying witness to 'deliver the documents and waive presence.'" Further, the non-party can be subpoenaed to testify and produce documents at a preliminary hearing, as "arbitral section 7 authority is not limited to witnesses at merits hearings, but extends to hearings covering a variety of preliminary matters" (including such matters as admissibility of evidence, motions for interim relief and privilege and authenticity issues).

Where no preliminary hearing is conducted, and the documents are sought as part of the normal pre-hearing discovery process, New Jersey counsel will have to rely on the New York Civil Practice Law and Rules for arbitration venued in New York. State law, however, may not be available where the dispute in the arbitration involves commerce, making it subject to the FAA. For example, the courts have repeatedly held that securities transactions involve commerce, adjudicating applications to compel arbitration of disputes involving securities transactions pursuant to the FAA. See *Rowe v. Morgan Stanley Dean Witter,* 191 F.R.D.298 (D.N.J. 1999). Thus, New Jersey counsel faced with an application to quash a pre-hearing discovery subpoena for a FINRA Dispute Resolution arbitration in New York must demonstrate that New York law, not the FAA, governs.

Further, even where counsel demonstrates that New York law applies, the CPLR limits an arbitration party's ability to obtain discovery from a non-party. The subpoena power under CPLR 7505 is restricted to the procuring of evidence for the hearing. See Alexander, "N.Y. Practice Commentaries," C 7505 (1998). Thus, the requesting party must obtain an order for discovery in aid of arbitration pursuant to CPLR 3102(c). Such an order, however, may be granted only where the requesting party demonstrates that the discovery is necessary and not merely convenient. *International Components Corp. v. Klaiber*, 54 A.D. 2d 550 (1st Dep't 1976). Thus, New Jersey counsel must satisfy a relatively high standard to obtain discovery in aid of arbitration.

Conclusion

Where a dispute involving New Jersey parties is arbitrated in New York, *Life Receivables* forecloses resort to the FAA as the basis for compelling a non-party to produce pre-hearing discovery for that arbitration. The non-party may nonetheless voluntarily comply with a pre-hearing discovery subpoena or waive appearance and produce prior to the hearing documents in response to a subpoena requiring the witness to testify at the hearing as a less burdensome alternative to resisting the subpoena. Moreover, the non-party must produce the documents before the hearing where he has been subpoenaed to testify at a preliminary hearing. Where the non-party refuses to comply with a pre-hearing discovery subpoena and there is no preliminary hearing for which the non-party can be subpoenaed, New Jersey counsel will have to rely on New York law to obtain that discovery before the hearing, but New York law will be a satisfactory alternative only where the FAA is inapplicable and the discovery is necessary and not merely convenient. ■