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Alternate Dispute Resolution

Rolling With Hay: Compelling Third-Party Discovery in Arbitration Proceedings

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Much has been written on a developing trend in arbitration making the process more like “the new litigation.” The verbiage varies, but the implication is the same: the initially separate sphere of arbitration has been so transformed as to have diffused, almost entirely, into the larger sphere of litigation. But often absent from those observations is any comparison of the capacity to compel unwilling third parties, through the issuance of subpoenas, to participate in discovery in the respective proceedings. The availability of third-party discovery, so long a staple of litigation, recently has been challenged in the arbitration context, resulting in a substantial rift between federal circuits. And arbitrators have been left to discern how to best comport with applicable law while respecting arbitration’s underlying goals of fairness and efficiency.

The Section 7 Circuit Split

It is common for parties to contractually elect prescribed rules for arbitra-

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tion that permit limited discovery. When the contemplated discovery includes the capacity to obtain prehearing testimony and documents from third parties, the issue arises whether a nonsignatory to the arbitration agreement who is unwilling to participate in the prehearing discovery process can be compelled legally to do so.

Section 7 of the FAA is the sole provision of that statute addressing the means of compelling third-party participation in an arbitration proceeding. It reads, in relevant part,

The arbitrators selected . . . 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. . . . [I]f any person . . . so summoned to testify shall refuse or neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators, or a majority of them, are sitting may compel the attendance of such person . . . before said arbitrator or arbitra-

tors, or punish said person . . . for contempt

The plain language affords to arbitrators the authority to issue subpoenas — enforceable by a district court — compelling otherwise unwilling third parties to appear before the arbitrator to testify and produce material documents. But the statute raises questions about whether an arbitrator is authorized to issue an enforceable subpoena seeking to compel an unwilling third party to participate in the discovery process.

Federal circuits have split on that issue. The Court of Appeals for the Fourth Circuit — the first to squarely address the question — held in *Comstat Corp. v. National Science Foundation*, 190 F.3d 269, 276 (4th Cir. 1999), that Section 7 affords to arbitrators the power to issue enforceable subpoenas to compel third parties to produce discovery only upon proof of “special need or hardship” by the party seeking the discovery. One year later, the Court of Appeals for the Eighth Circuit went further, concluding that efficient resolution of arbitral disputes requires construing Section 7 as implicitly recognizing an arbitration panel’s authority to compel third-party testimony and document production prior to a hearing. See *In re Sec. Life Ins. Co. of Am.*, 228 F.3d 865, 870-71 (8th Cir. 2000). That same view had been adopted previously by a district court in the Sixth Circuit. See *Meadows Indem. Co., Ltd. v. Nutmeg Ins. Co.*, 157 F.R.D. 42, 45 (M.D. Tenn. 1994).

But the Third Circuit Court of

Appeals, speaking through then-Judge (now United States Supreme Court Justice) Alito, opted for a narrow construction of Section 7. In the seminal decision *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404, 407-08 (3d Cir. 2004), the court held that Section 7 “speaks unambiguously” to the scope of an arbitrator’s subpoena power, and that the language does not support a “power-by-implication analysis.” Rather, an arbitrator’s subpoena power extends only “to situations in which the non-party has been called to appear in the physical presence of the arbitrator.” Thus, in a dispute between an employer and its former employee arising out of a post-employment restrictive covenant, an arbitrator could not subpoena the employee’s current employer, PriceWaterhouseCoopers, and compel its participation in discovery.

In November 2008, the Second Circuit Court of Appeals adopted *Hay*’s narrow construction of Section 7. See *Life Receivables Trust v. Syndicate 102 at Lloyd’s of London*, 549 F.3d 210, 217-18 (2d Cir. 2008). Importantly, the Second Circuit referred to an “emerging rule” in federal courts that “the arbitrator’s subpoena authority under FAA [Section] 7 does not include the authority to subpoena nonparties or third parties for prehearing discovery even if a special need or hardship is shown.”

Conforming to *Hay*

Given this emerging trend, arbitrators must determine how best to comport with the central tenet of *Hay* and its progeny while ultimately achieving equitable and efficient results. That initially necessitates defining *Hay*’s true force and effect. To be sure, the language employed by the Third Circuit appears encompassing. But

as with any seminal decision, its true force and effect can only be assessed as it is applied in future cases. In any event, the focus will be on how, and when, to obtain from unwilling third parties discovery that is largely equivalent to that which would be obtained via a subpoena issued in a litigation requiring the third party to be deposed or to produce documents.

As suggested by Judge Chertoff’s concurrence in *Hay*, the “how” is easy; an arbitrator can commence a hearing, and, consistent with the arbitrator’s Section 7 power, issue a subpoena to the unwilling third party to appear and to provide all material documents and testify if necessary. That subpoena would be enforceable under Section 7. Afterwards, the arbitrator can adjourn the hearing to a later date, at which point the parties will have had time to marshal the scope and impact of the information that the third party produced.

But the “when,” particularly in respect of when practitioners should request a “pre-hearing hearing,” is far more nuanced. While the aforementioned procedure certainly would appear to be in full accord with *Hay*, it is formalistic, costly, and, for lack of a better word, messy. The parties will have to compensate the arbitrator for his or her time simply to have that arbitrator “preside” over what is, in effect, a formal substitute for prehearing third-party discovery. Moreover, the role of the arbitrator at such a “hearing” is ambiguous. While arbitrators generally exercise substantial control over hearings, doing so in this context may inhibit the very purpose for performing the procedure in the first instance. That is particularly so where the “hearing” envisions actual testimony from a third party as opposed to where, as in *Hay*, a party only seeks document production. And while it is typical in litigation to direct a court to only a few

salient portions of a third party’s much more substantial deposition testimony, the arbitrator would be exposed to the entire scattershot questioning usually employed in a deposition. Thus, there would be no sleek reduction to cogency — or particular knowledge of answers that a third party would give to certain questions — before relevant information is placed before the decision-maker. That may well have a chilling effect both on fully developing the third party’s testimony and on a party’s demanding third-party discovery in the first instance.

Conclusion

The circuit split on the proper construction of Section 7 may well prime the issue for review by the United States Supreme Court. After all, the scope of a federal statute should not vary depending on which jurisdiction construes it. But in the interim, arbitrators in federal circuits that adhere to the emerging rule initially articulated in *Hay* must conform to that rule and should do so in the manner most consistent with the fundamental principles of fairness and efficiency underlying the arbitration process. Where a party to arbitration demands discovery from an unwilling third party, and the arbitrator deems the need for that discovery significant, the arbitrator can agree to hold a “pre-hearing hearing” and, by issuing an enforceable subpoena, compel the unwilling third party to attend, testify, and produce material documents. But whether a party should demand such a hearing in the first instance may implicate significant strategic and financial considerations. Thus, *Hay* and its progeny highlight for practitioners an emerging, nuanced procedural issue unique to arbitration that requires careful consideration. ■