CLEARY
GOTTLIEB

NEW YORK WASHINGTON PARIS BRUSSELS LONDON MOSCOW FRANKFURT COLOGNE ROME MILAN HONG KONG BEIJING

Second Circuit Adds to Circuit Split on Arbitration Discovery, Holding that Third Parties Cannot be Compelled to Produce Discovery Documents under §7 of the Federal Arbitration Act

New York
December 4, 2008

The Second Circuit held last week that §7 of the Federal Arbitration Act (FAA) does not authorize arbitrators to issue pre-hearing document subpoenas to third parties. In *Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, No. 07-1197-cv (2d Cir. Nov. 25, 2008), the court favored a narrow interpretation of § 7, the provision of the FAA which provides arbitrators the power to subpoena parties to attend a hearing. The Second Circuit's decision was in keeping with the most recent previous appellate decision on the issue of arbitration discovery issued by the Third Circuit in *Hay Group v. E.B.S. Acquisition Corp.*, 360 F.3d 404 (3d Cir. 2004), but it conflicted with prior circuit decisions on this issue.

The Second Circuit did not close the door entirely to the possibility of compelling non-parties to produce discovery documents. First, the court held that while non-parties from whom discovery documents were sought must be called as witnesses, the § 7 subpoena power extends to "preliminary matters" as well as merits hearings. Second, it noted that in some instances arbitrators could formally join additional parties so that production of documents could be compelled directly.

Legal Issues

The Circuits have split over the issue at the heart of *Life Receivables Trust*, namely, whether § 7 of the FAA permits arbitrators to compel non-parties to produce documents prior to the hearing. The section is mainly concerned with the arbitral subpoena power, referring to the production of documents by non-parties only in the context of their appearance before the arbitral tribunal: "The arbitrators…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." 9 U.S.C. § 7.

Prior to *Life Receivables Trust*, three different circuits had read the provision differently. In *In Re Arbitration Between Sec. Life Ins. Co. of Am.* the Eighth Circuit favored discovery, finding that § 7 contains an implicit power to subpoena the pre-hearing production of documents because efficiency interests are "furthered by permitting a party to

© Cleary Gottlieb Steen & Hamilton LLP, 2008. All rights reserved.

This memorandum was prepared as a service to clients and other friends of Cleary Gottlieb to report on recent developments that may be of interest to them. The information in it is therefore general, and should not be considered or relied on as legal advice.

review and digest relevant documentary evidence prior to the arbitration hearing." 228 F.3d 865, 870 (8th Cir. 2000). The Fourth Circuit, in *Comsat Corp. v. Nat'l Sci. Found.*, advanced a more complex reading of the provision. The court held that "by its own terms" § 7 did not authorize arbitral panels to subpoena documents from third parties prior to hearings, but it left room for the possibility that a party might petition the court to "compel pre-arbitration discovery upon a showing of special need or hardship," a need which it did not define and which it found to be absent from the case at hand. 190 F.3d 269, 275, 276 (4th Cir. 1999).

Most recently, the Third Circuit in *Hay Group* held that neither the express language nor the history of § 7 supported an arbitral power to compel pre-hearing document discovery from third parties. The Second Circuit in *Life Receivables Trust* expressed support for *Hay Group*'s holding, stating that it "signaled…an 'emerging rule.'" Slip op. at 10.

***Life Receivables Trust*: Background and Disposition**

Life Receivables Trust concerned a dispute over death benefits under a contingent cost insurance policy in which Peachtree Life Insurance was a life settlement provider that transferred its interest in a purchased policy to the Life Receivables Trust, a vehicle it created for this purpose. The purchase was underwritten by Syndicate 102, which agreed to assume the policy obligations and pay the death benefits in the event that the insured exceeded his or her life expectancy by more than two years. When the insured individual met this condition, Life Receivables Trust attempted to collect from Syndicate 102, but the underwriter refused payment on the grounds of fraudulent misrepresentation. The policy mandated arbitration in case of dispute.

In the course of arbitration, Peachtree refused to comply with a discovery subpoena requested by Syndicate 102 and issued by the arbitral panel, claiming it was not a party to the arbitration and thus not bound by the panel's orders. Peachtree then filed a motion to quash the subpoena in federal court. The Southern District upheld the subpoena order, and Peachtree appealed.

The Second Circuit had declined to rule on the issue in two prior cases, but in *Life Receivables Trust* it held that the express language of § 7 does not authorize arbitrators to issue pre-hearing document subpoenas to non-party entities. "The language of § 7 is straightforward and unambiguous," the court held; "if Congress wants to expand arbitral subpoena authority, it is fully capable of doing so." Slip op. at 10.

The court rejected both of the arguments Syndicate 102 advanced to support the compulsion of document production by Peachtree. First, the fact that Peachtree was "intimately related" to Life Receivables Trust did not bring the entity under the ambit of § 7, which "contains no discovery exception for closely related entities." Slip op. at 11. Second,

the court rejected Syndicate's contention that § 7 covers entities which are party to the arbitration *agreement*, even if not to the arbitration *proceeding*: "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." Slip op. at 12.

At the conclusion of its opinion, the Second Circuit did offer some solace to parties seeking to acquire pre-hearing documents in an arbitration. Referencing a concurring opinion in *Hay Group*, the Second Circuit concluded that despite its holding on § 7, its plain meaning interpretation of that provision "'does not leave arbitrators powerless' to order the production of documents.'" Slip op. at 13. The court reaffirmed its opinion in *Stolt-Nielsen SA v. Celanese AG*, 430 F.3d 567 (2d Cir. 2005), stating that the § 7 authority to subpoena witnesses and compel them to produce documents extended to "hearings covering a variety of preliminary matters," not just merits hearings. Slip op. at 14. The court also noted that arbitrators could formally join additional parties and thus compel production of documents.

Conclusion

Life Receivables Trust continues the circuit split over the question of arbitration discovery under § 7 of the Federal Arbitration Act, advancing a less expansive vision of the provision than have some circuits. However, the Second Circuit did demonstrate flexibility in its prescriptions to parties, suggesting creative avenues for the compulsion of production of pre-hearing documents and signaling a possible willingness to permit some non-party discovery efforts in arbitrations. Under the Second Circuit's ruling, a way to compel document production by a third party might be to schedule a preliminary hearing for the purpose of summoning the witness with the witness's documents and then either question the witness or simply have the witness identify the documents under oath, as at a deposition of a document custodian in a civil litigation. However, it remains to be seen how far district courts and arbitrators will be willing to permit this indirect approach to obtaining nonparty documents to extend in future arbitrations.

* * *

For additional information about any of the issues raised above, please do not hesitate to contact Jonathan Blackman, Howard Zelbo or Carmine Boccuzzi, Jr. in the Firm's New York office (212-225-2000).

CLEARY GOTTLIEB STEEN & HAMILTON LLP

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

PARIS
12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 40 74 68 88 Fax

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

MOSCOW
Cleary Gottlieb Steen & Hamilton LLP
CGS&H Limited Liability Company
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 660 8500
7 495 660 8505 Fax

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

COLOGNE
Theodor-Heuss-Ring 9
50668 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

ROME
Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

MILAN
Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

BEIJING
Twin Towers – West
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax