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SECOND CIRCUIT RULES THAT PRE-HEARING DISCOVERY CANNOT BE COMPELLED FROM THIRD-PARTIES IN ARBITRATION

The United States Court of Appeals for the Second Circuit last week handed down an important ruling that adopts a narrow view of the power of arbitrators to compel the production of evidence from non-parties. Confronted with an issue that has split the circuits, the Court held that arbitrators do not have the power, under section 7 of the Federal Arbitration Act ("FAA"), to compel non-parties to an arbitration to produce documents prior to an arbitration hearing.

Before its decision of November 25, 2008 in *Life Settlements Corp v. Syndicate 102 at Lloyd's of London*,[1] the Second Circuit had twice avoided the opportunity to address the provision by non-parties of pre-hearing evidence.[2] With its decision in *Life Settlements,* the Second Circuit has joined the Third Circuit in concluding that "section 7 does not enable arbitrators to issue pre-hearing document discovery from entities not party to the arbitration proceedings."[3] In so doing, the Court noted, and no doubt has fueled, a "growing consensus" among various courts in favor of the Third Circuit's reasoning.[4]

Two other circuits have considered the issue but ruled differently. The Eighth Circuit, in *In re Arbitration Between Sec. Life Ins. Co. of Am.*,[5] found that section 7 of the FAA does authorize arbitrators to order pre-hearing document discovery from non-parties. The Fourth Circuit, in *Comsat Corp. v. Nat'l Sci. Found.,*[6] held that the FAA *may* bestow such powers on an arbitrator – at least where there is a special need for the documents.

The Facts and Proceedings Below

The case arose out of what the Second Circuit noted is the "somewhat macabre market"[7] for the re-purchase

[1] *Life Settlements Corp v. Syndicate 102 at Lloyd's of London.*, No. 07-1197-cv, 2008 (2d Cir. November 25, 2008).
[2] *See Stolt-Nielsen SA v Celanese AG,* 430 F. 3d 567, 569 (2d Cir. 2005); *Nat'l Broadcasting Co. v. Bear Stearns & Co., Inc.,* 165 F.3d 184, 187-88 (2d Cir. 1999).
[3] *Life Settlements*, No. 07-1197-cv, 2008, at 11. *See also Hay Group, Inc. v. E.B.S. Acquisition Corp.,* 360 F. 3d 404 (3d Cir. 2004).
[4] *Life Settlements*, No. 07-1197-cv, 2008, at 10.
[5] *In re Arbitration Between Sec. Life Ins. Co. of Am.,*228 F. 3d 865 (8th Cir. 2000).
[6] *Comsat Corp. v. Nat'l Sci. Found.,* 190 F.3d 269, 275 (4th Cir. 1999).
[7] *Life Settlements*, No. 07-1197-cv, 2008, at 3.

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of life insurance policies. Life Settlements Corp, trading as Peachtree Life Settlements ("Peachtree"), purchased life insurance policies from elderly insureds. In return for transferring their life insurance policies to Peachtree, the insureds received cash, in an amount discounted from the face value of the policies. As a hedge against the possibility that the insureds might live longer than expected, Peachtree bought "contingent cost insurance" policies from Syndicate 102.

Peachtree purchased two life insurances policies owned by a Mr. Wang, before transferring its interests in the policies to a related trust, the Life Receivables Trust (the "Trust"). On behalf of the Trust, Peachtree obtained a contingent cost insurance policy from Syndicate 102. The policy contained a mandatory arbitration clause.

Mr. Wang outlived his calculated life expectancy, triggering Syndicate 102's obligation to make a payment to the Trust. When Syndicate 102 refused, arguing that the Trust had fraudulently misrepresented the date it had acquired the policies and had fraudulently calculated Mr. Wang's life expectancy, the Trust commenced arbitration.

In response to discovery requests, the Trust produced documents but asserted that it did not control Peachtree and had no ability to compel the production of Peachtree's documents. Syndicate 102 requested that the arbitrator issue a subpoena requiring Peachtree to produce its responsive documents.

Peachtree filed suit in the Southern District of New York to quash an arbitral subpoena requiring Peachtree to produce the documents. The district judge granted Syndicate 102's motion to enforce the subpoena, 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." Peachtree appealed.

The Decision on Appeal

The Second Circuit observed on appeal that Section 7 is the only provision of the FAA that addresses discovery. Section 7 reads, in relevant part:

> "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."[8]

The Court then traced the approaches of the other circuits.[9]

First, the Court noted the Eighth Circuit's view that although the statute does not "explicitly authorize the arbitration panel to require the production of documents for inspection by a party … implicit in an arbitration panel's power to subpoena relevant documents for production at a hearing is the power to order the production of relevant documents for review by a party prior to the hearing."[10] Next, the Court described the Fourth Circuit's holding that, while section 7 does not bestow upon an arbitrator "the authority to order non-parties to … provide the litigating parties with documents during prehearing discovery," such a power can be read into the FAA, for the purposes of arbitral efficiency, "upon a showing of special need or hardship."[11]

Finally, the Court considered the Third Circuit's decision in *Hay Group*, where then-Judge Alito held that the plain language of section 7 "unambiguously restricts an arbitrator's subpoena power to situations in which the non-party has been called to appear in the physical presence of the arbitrator and to hand over the documents at that time."[12] According to Judge Alito, such a narrow subpoena

[8] 9 U.S.C. sec. 7.

[9] *Life Settlements*, No. 07-1197-cv, 2008, at 8-10.
[10] *In re Security Life Ins. Co.,* 228 F.3d at 870-871.
[11] *Comsat Corp.,* 190 F. 3d at 275.
[12] *Hay Group,* 360 F.3d at 407.

power, when placed in its historic context, was especially logical since it mirrored the earlier version of Federal Rule of Civil Procedure 45.

The Second Circuit determined the language of section 7 to be "straightforward and unambiguous" in prescribing that "documents are only discoverable in arbitration when brought before arbitrators by a testifying witness."[13] The Court stated that its "only role is to enforce that language according to its terms."[14] The Court went on to reason that, at the time the FAA was enacted, "pre-hearing discovery in civil litigation was generally not permitted. 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."[15] Although observing that there "may be valid reasons to empower arbitrators to subpoena documents from third parties", the Court concluded that a statute's "clear language" does not "morph into something more just because courts think it makes sense for it do so."[16]

The Second Circuit also rejected Syndicate 102's argument that, whatever its application to third parties, section 7 authorizes arbitrators to subpoena documents from entities, like Peachtree, that are parties to the arbitration agreement. The Court noted 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."[17]

The Decision's Implications

Although firmly rejecting the notion that pre-hearing discovery can be compelled in arbitration from non-parties, the Second Circuit noted that "arbitrators possess a variety of tools to compel discovery from non-parties."[18] Consistent with its "plain reading" of section 7, the Court stated that arbitrators may "order 'any person' to produce documents so long as that person is called as a witness at a hearing."[19] The Court also emphasized that section 7's arbitral power to subpoena a witness to appear before the panel with documents is not limited to witnesses at merits hearings "but extends to hearings covering a variety of preliminary matters."[20]

The Second Circuit thus confirmed that an arbitrator may still compel a non-party to produce evidence prior to the hearing on the merits. To do so, however, an arbitrator must subpoena a non-party to appear at an additional hearing. And, as noted by the Court, a non-party, when faced with the cost and inconvenience of appearing at a hearing to produce documents, may choose simply to "deliver the documents and waive presence."[21]

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[13] *Life Settlements*, No. 07-1197-cv, 2008, at 10.
[14] *Id.*
[15] *Id.*
[16] *Id.* at 10-11.
[17] *Id.* at 12.
[18] *Id.* at 13.
[19] *Id.*
[20] *Id.* at 14.
[21] *Id.*

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