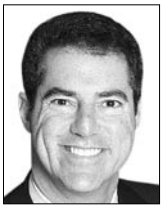
New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM

An incisivemedia publication
VOLUME 241—NO. 18
WEDNESDAY, JANUARY 28, 2009

SECOND CIRCUIT REVIEW

Expert Analysis

Prehearing Discovery From Third Parties, Federal Arbitration Act



By **Martin Flumenbaum** | And **Brad S. Karp**

This month, we discuss *Life Settlements Corp. v. Syndicate 102 at Lloyd's London*,[1] an important decision from the U.S. Court of Appeals for the Second Circuit that deepens a circuit split on the issue of whether an arbitrator can compel prehearing discovery from nonparties.

The Second Circuit has twice previously deferred ruling on this question.[2] In its decision, written by Judge Richard C. Wesley and joined by Judge Peter W. Hall and District Judge Louis F. Oberdorfer, the court reversed the district court's order to enforce an arbitral subpoena and held that §7 of the Federal Arbitration Act[3] does not authorize an arbitrator to compel prehearing document discovery from a nonparty to the arbitration.

In so ruling, the court squarely rejected the position of the Eighth Circuit, which held that §7 does authorize arbitrators to issue prehearing subpoenas to nonparties, and the position of the Fourth Circuit, which held that an arbitrator may issue such subpoenas where there is a "special need" for the documents.[4]

Instead, the Second Circuit agreed with the position of the Third Circuit, in an opinion authored by then-Judge (now Supreme Court Justice) Samuel Alito, and concluded that the "plain language" of §7 unambiguously limits an arbitrator's subpoena power over nonparties to situations in which the nonparty has been called to appear in the physical presence of the arbitrator and to hand over documents at that time.[5]

Life Settlements Corp., doing business as Peachtree Life Settlements (Peachtree), is a company engaged in, what the Court describes as, "the somewhat-macabre market" by which Peachtree purchases life insurance policies from still-living individuals. The price is based on Peachtree's assessment of various factors, most notably its estimate of how long the individual is going to live. Peachtree becomes the beneficial owner and pays the premiums. Peachtree holds some of the policies for its own accounts, and others for related entities, including Life Receivables Trust (the trust), a special-purpose vehicle created to hold the policies. Peachtree has no beneficial ownership or financial interest in the trust, though it does continue to receive contractual fees from the trust. To mitigate the risk that the insured might live longer than expected, Peachtree buys contingent cost insurance from Syndicate 102. If the insured individual lives more than two years longer than expected, Syndicate 102 pays the death benefit to Peachtree or its relevant affiliate and assumes the policy itself.

The dispute in this case arose from one such policy—obtained and serviced by Peachtree, held by the trust and insured by Syndicate 102—on an individual who outlived his calculated life expectancy by more than two years. Peachtree demanded payment from Syndicate 102, and Syndicate 102 refused claiming fraud as to the date on which the policy was obtained and the insured's calculated life expectancy. The trust, pursuant to the insurance policy's mandatory arbitration clause, initiated an arbitration against Syndicate 102.

Syndicate 102 sought discovery from the trust and Peachtree. The trust produced its requested documents, but responded that it had no control over Peachtree and could not compel the production of Peachtree's documents. The trust also agreed to produce certain Peachtree documents in its possession. Syndicate 102 sought to join Peachtree in the arbitration, but Peachtree refused and no joinder was ordered. Per Syndicate 102's request, the arbitral panel ordered the trust to produce all documents in its possession related to Peachtree. The trust responded that Peachtree had not provided all the requested documents, which prompted the panel to order the trust to obtain the documents from Peachtree. Peachtree notified the arbitrators that it refused to comply, on the basis that it was not a party to, or in any way bound by, the arbitration. Syndicate 102 sought, and the arbitration panel granted, a subpoena requiring Peachtree to provide the documents.

District Court Decision

Peachtree filed suit in the U.S. District Court for the Southern District of New York to quash the subpoena, as relevant here, on the ground that the arbitrator could not order prehearing discovery from a nonparty. Syndicate 102 cross-moved to compel Peachtree's compliance. The District Court granted Syndicate 102's motion, 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."[6]

The Second Circuit reversed the District Court's order. The court focused first on the language of §7, the only Federal Arbitration Act provision to address discovery. That section states that the arbitrators "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

MARTIN FLUMENBAUM *and* BRAD S. KARP *are litigation partners at Paul, Weiss, Rifkind, Wharton & Garrison LLP specializing in complex commercial and white-collar criminal defense litigation.* JAREN JANGHORBANI, *a litigation associate at the firm, assisted in the preparation of this column.*

them any book, record, document, or paper which may be deemed material as evidence in the case."[7] As the circuit has previously noted, the language in §7 only expressly addresses documents brought before the arbitrator at a hearing. This is the first time the court reached the issue of whether the section can be used to compel prehearing discovery, particularly from nonparties.

Other Circuits' Views

The court then considered the decisions of the other circuits on this issue. First, the court noted that the Eighth Circuit has held that the power to subpoena relevant documents prior to a hearing is implicit in an arbitration panel's power to subpoena documents at a hearing.[8] The Fourth Circuit has concluded that arbitral powers are limited to those enumerated in the statute, and thus would not typically include prehearing subpoenas. Nevertheless, because arbitral efficiency could be severely impinged by the inability to review and digest evidence before a hearing, the Fourth Circuit allows an exception upon showing of special need or hardship.[9]

The court then focused its attention on the Third Circuit's decision in *Hay Group*. In that decision, then-Judge Alito focused on the language in §7, which "unambiguously restricts an arbitrator's subpoena power to situations in which the nonparty has been called to appear in the physical presence of the arbitrator and to hand over the documents at that time."[10] The *Hay Group* court rationalized the narrow scope of the provision, looking to its historical context. Section 7 mirrors the old language of Federal Rule of Civil Procedure 45. Prior to its 1991 amendment, Rule 45 also expressly permitted subpoena over third-party documents only when produced at a hearing. The Second Circuit observed that *Hay Group* appears to be the emerging rule in lower courts.

The court next recited the principle that where a statute's language is clear, the district court's only role is to enforce that language. The court noted that the amendment of Rule 45 further indicated that if Congress wanted to expand arbitral subpoena power, it could do so. The court recognized that while there may be reasons for expanded subpoena power, it "must interpret a statute as it is, not as it might be."[11]

The court considered two arguments from Syndicate 102 as to why the rule as written should not apply to Peachtree. First, the court rejected Syndicate 102's argument that because Peachtree is "intimately related" to the trust it should be subject to subpoena power.[12] Section 7, the court noted, enunciates no exception for closely related entities. Further, in a footnote, the court stated that the close relationship between Peachtree and the trust was more compelling as a reason why it might have been—and may yet be—joined as a party to the arbitration.[13] Second, the court rejected Syndicate 102's argument that because Peachtree too was a party to the arbitration agreement, if not the arbitration itself, it should be subject to subpoena power. The court rejected this also as contrary to the "plain language" of §7.

The court then noted that the arbitration agreement, not §7, is the root of all of the arbitrator's power. The policy in this case incorporated by reference the American Arbitration Association Rules.

'Life Settlements v. Syndicate 102,' a key Second Circuit decision, deepens a circuit split on the issue of whether an arbitrator can compel prehearing discovery from nonparties.

AAA Rule 31(d) governs subpoenas, and can, the court acknowledged, be read as authorizing subpoenas to nonparties. The court, however, read the rule to mean that a court can issue orders that the nonparty may voluntarily follow. Where a party refuses to comply, the only recourse is to §7.

Implications

Finally, the court discussed the practical implications of its ruling, relying heavily on the concurrence in the *Hay Group* opinion authored by then-Judge Michael Chertoff. Section 7 allows subpoena power over documents by any person so long as that person is appearing at a hearing. This is a broad power, the court noted, because "hearing" has been interpreted to include a wide variety of preliminary matters. Moreover, the inconvenience of having to appear at a hearing may compel third parties to produce their documents voluntarily and waive presence. The inconveniences caused by §7, the court reasoned, simply require that the party seeking discovery consider whether the production sought is truly necessary. The court concluded its opinion noting that joinder in some cases would be appropriate, particularly where, as here, the third party too is a party to the arbitration agreement.

Conclusion

The Second Circuit thus has made clear that arbitrators cannot compel third-party prehearing production of documents pursuant to §7 of the Federal Arbitration Act. In so doing, it further deepened a split among the circuits on this issue. Furthermore, while it considered the practical implications of its ruling, the court displayed a commitment to a strict textual analysis in reaching its result.

1. Docket No. 07-1197-cv, 2008 WL 4978550 (2d Cir. Nov. 25, 2008).
2. *Life Settlements Corp.,* 2008 WL 4978550 at * 1 & n.2 (citing *Stolt-Nielsen SA v. Celanese AG,* 430 F.3d 567, 569 (2d Cir. 2005); *Nat'l Broadcasting Co. v. Bear Stearns & Co.,* 165 F.3d 184, 187-88 (2d Cir.1999)).
3. 9 U.S.C. §7.
4. *Life Settlements Corp.,* 2008 WL 4978550 at * 1 (citing *In re Arbitration Between Sec. Life Ins. Co. of Am.,* 228 F.3d 865, 870-71 (8th Cir.2000); *COMSAT Corp. v. Nat'l Sci. Found.,* 190 F.3d 269, 275 (4th Cir.1999)).
5. *Life Settlements Corp.,* 2008 WL 4978550 at * 1, *4-5 (citing *Hay Group Inc. v. E.B.S. Acquisition Corp.,* 360 F.3d 404, 407 (3d Cir. 2004)).
6. *Life Settlements Corp.,* 2008 WL 4978550 at *3.
7. Id. (citing 9 U.S.C. §7).
8. *Life Settlements Corp.,* 2008 WL 4978550 at *4 (citing *In re Sec. Life Ins. Co.,* 228 F.3d at 870-71).
9. *Life Settlements Corp.,* 2008 WL 4978550 at *4 (citing *COMSAT Corp.,* 190 F.3d at 275-76).
10. *Life Settlements Corp.,* 2008 WL 4978550 at *4-5 (citing *Hay Group,* 360 F.3d at 407).
11. *Life Settlements Corp.,* 2008 WL 4978550 at *5.
12. Id.
13. Id. at n.10.