

## **How the Creep of United States Litigation-Style Discovery and Appellate Rights Affects the Efficiency and Cost-Efficacy of Arbitration in the United States**

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### **What is purpose of arbitration?**

The popularity of arbitration rests in considerable part on its asserted efficiency and cost-effectiveness--characteristics said to be at odds with full-scale litigation in the courts, and especially at odds with the broad-ranging discovery made possible by the Federal Rules of Civil Procedure. See [\*Allied-Bruce Terminix Cos. v. Dobson\*, 513 U.S. 265, 280, 115 S.Ct. 834, 130 L.Ed.2d 753 \(1995\)](#) advantages of arbitration are that it is "usually cheaper and faster than litigation; ... can have simpler procedural and evidentiary rules; ... normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties") (quoting [H.R.Rep. No. 97-542](#), at 13 (1982), U.S. Code Cong. & Admin. News 1982 at 765, 777).  
[\*National Broadcasting Co., Inc. v. Bear Stearns & Co., Inc.\*](#), 165 F.3d 184 (2d Cir. 1999) (Cabranas, J.)

Over the last several years, however, at least in our practice, we have noticed that parties seem more and more bent on conducting more discovery, interposing motions and requiring panels to issue reasoned awards to be scrutinized by confirming courts. Such efforts threaten to erode the usefulness of arbitration by eliminating these advantages. The two examples below are from cases I have handled in the past few years and illustrate these problems:

### **Examples of Problems with Discovery and Trend to Request Reasoned Decisions in Arbitration Proceedings**

#### **Party Discovery: Startup Inc. v. Powerful Vendor**

- Vendor uses form contract with arbitration clause.
- Calls for AAA arbitration before 3 arbitrators.
- Silent as to rules.
- Startup makes down payment on contract to provide hardware/software and services. Vendor doesn't deliver working system.
- Vendor brings arbitration against Startup Inc., for balance of contract price. Startup counterclaims for return of deposit.
- Vendor serves Startup with extensive document requests, more than 100 interrogatories and notices to admit, and seeks discovery depositions of parties and non-parties.
- Vendor also objects or fails to produce in response to Startup's fairly typical document requests.

**Third-Party Discovery and Reasoned Decision:  
Terminated CEO v. Financial Services Corp.**

- Arbitration between large, multinational Financial Services Corp. and Terminated CEO.
- Arbitration agreement contained in retention agreement from an intercompany transaction.
- AAA; 3 Arbitrators.
- Very expensive; briefs, written and oral motions for directed verdict.
- In nod to expense, contract provided that Financial Services Corp. would pay arbitrators' fees, filing fees and attorneys' fees and expenses, win or lose.
- Arbitration Agreement did not provide for reasoned decision, but Financial Services Corp. demanded it and the panel wanted to write one:
  - In light of other party's financial responsibility, what would Terminated Executive's objection signal?
- Panel writes two reasoned decisions, one on motion for directed verdict, one a final decision.
  - On directed verdict, dismissed a claim later supported by admission of Respondent's Chairman on cross examination.
- On the eve of the hearings, Financial Services Corp. subpoenaed Terminated CEO's wife.
  - Arbitration in NY
  - Wife in Midwest, caring for children.
  - I objected, panel ordered deposition during break in hearing.

**PART ONE: To What Extent Should Discovery be Allowed in US Arbitration?**

**I. Types of Discovery: Are Some Forms More Acceptable Than Others?**

**A. Documents**

- Exchange of Documents is necessary to effective dispute resolution.
- Least intrusive.
- Most Cost Efficient.

**B. Written Discovery (i.e., Interrogatories, Notices to Admit)**

- Not provided for by rules of any major U.S. arbitral forum
- Expensive.
- Time consuming.
- Fodder for discovery disputes, particularly if this suits a party's purpose.
- Less useful in terms of discovery, at any rate.

## C. Depositions

### i. Discovery Depositions

- If allowed, expense of preparation, transcript, utilization of information.
- Expanded record.
- Need for additional matters on which arbitrators need to rule.
- What is left to differentiate proceeding from litigation?

### ii. Depositions of Persons Beyond Jurisdiction

- Makes some sense if limited and person is important
- But parties should be compelled to testify in person
- Most courts find that third party depositions are not allowed.

## D. Third-Party Discovery

- Documents are necessary.
- FAA provides for subpoena of documents only.

## II. What Discovery is Allowed of Parties?

### A. What do Courts Say?

- Federal courts in NY are fond of saying:  
“[F]ull scale discovery is not automatically available in arbitration, as it is in litigation. Everyone knows that is so; thus the unavailability of the full panoply of discovery devices, with their attendant burdens of time and expense, may fairly be regarded as one of the bargained-for benefits (or burdens, depending on one's subsequent point of view) of arbitration.” Integrity Ins. Co., in Liquidation v. American Centennial Ins. Co., 885 F. Supp. 69 (S.D.N.Y. 1995).
- This means that courts are unlikely to order additional discovery in aid of arbitration if the arbitrators refuse.
- Courts are also reluctant to limit any discovery that a panel might order, finding broad authority for document discovery in arbitration rules, such as the AAA's.

## **B. AAA Rules**

### **AAA: R-21. Exchange of Information**

(a) At the request of any party or at the discretion of the arbitrator, consistent with the expedited nature of arbitration, the arbitrator may direct

- i) the production of documents and other information, and
- ii) the identification of any witnesses to be called.

(b) At least five business days prior to the hearing, the parties shall exchange copies of all exhibits they intend to submit at the hearing.

(c) The arbitrator is authorized to resolve any disputes concerning the exchange of information.

## **C. NASD Rules**

### **10321. General Provisions Governing Pre-Hearing Proceedings**

#### **(a) Requests for Documents and Information**

The parties shall cooperate to the fullest extent practicable in the voluntary exchange of documents and information to expedite the arbitration. Any request for documents or other information should be specific, relate to the matter in controversy, and afford the party to whom the request is made a reasonable period of time to respond without interfering with the time set for the hearing.

#### **(b) Document Production and Information Exchange**

(1) Any party may serve a written request for information or documents ("information request") upon another party 45 calendar days or more after service of the Statement of Claim by the Director of Arbitration or upon filing of the Answer, whichever is earlier....

### **10322 (b) Power to Direct Appearances and Production of Documents**

The arbitrator(s) shall be empowered without resort to the subpoena process to direct the appearance of any person employed or associated with any member of the Association and/or the production of any records in the possession or control of such persons or members. Unless the arbitrator(s) directs otherwise, the party requesting the appearance of a person or the production of documents under this Rule shall bear all reasonable costs of such appearance and/or production.

### **III. What Discovery is Allowed of Non-Parties?**

**AAA:**

#### **R-31. Evidence**

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(d) An arbitrator or other person authorized by law to subpoena witnesses or documents may do so upon the request of any party or independently.

- Law of many states, such as New York, allows lawyers to issue subpoenas.
- FAA confers subpoena only on arbitrators, not counsel.

#### **NASD: 10322. Subpoenas and Power to Direct Appearances**

##### **(a) Subpoenas**

The arbitrators and any counsel of record to the proceeding shall have the power of the subpoena process as provided by law. All parties shall be given a copy of a subpoena upon its issuance. Parties shall produce witnesses and present proofs to the fullest extent possible without resort to the subpoena process.

##### **Courts:**

General weight of authority is that FAA, §7 allows for arbitrators to subpoena third party to appear at a hearing and to produce documents, but not for pre-hearing depositions.

- Many district courts and some of the Circuits have considered the question and held this way, including the 3<sup>rd</sup>, 8<sup>th</sup> and 6<sup>th</sup> Cir., although the 6th did not reach deposition question.

##### **WHY?**

- Burdensome on non-party.
- Non-party never consented to arbitration.
- Nothing to protect non-party from abuse or harassment at deposition, forcing non-party to commence proceeding in court.
- And, while I haven't seen it among any court's arguments, I suspect a general reluctance to sanction depositions in arbitration.

Other Circuits have come to a different conclusion, such as the 4<sup>th</sup> Circuit, which held that:

- “Nowhere does the FAA grant an arbitrator the authority to order non-parties to appear at depositions, or the authority to demand that non-parties provide the litigating parties with documents during prehearing discovery.”
- The 4<sup>th</sup> Circuit relied on a literal reading of Section 7.
- The 4<sup>th</sup> Circuit emphasized that the arbitrator’s subpoena power under section 7 is “decidedly not” co-extensive with a U.S. District Court’s subpoena power.

COMSAT Corp. v. National Science Foundation, 190 F.3d 269 (4th Cir.1999).

There is some variation within particular Circuits, for example:

The 2<sup>nd</sup> Circuit has left the question open, but there are numerous SDNY decisions that follow the Third Circuit Rule. But Judge Jed Rakoff recently followed the 4<sup>th</sup> Circuit Rule in Odfjell v. Celanese, 328 F.Supp.2d. 505 (S.D.N.Y. 2004)

### **Text of Section 7:**

#### **9 USC §7:**

The arbitrators selected either as prescribed in this title or otherwise, 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. The fees for such attendance shall be the same as the fees of witnesses before masters of the United States courts. Said summons shall issue in the name of the arbitrator or arbitrators, or a majority of them, and shall be signed by the arbitrators, or a majority of them, and shall be directed to the said person and shall be served in the same manner as subpoenas to appear and testify before the court; if any person or persons 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 or persons before said arbitrator or arbitrators, or punish said person or persons for contempt in the same manner provided by law for securing the attendance of witnesses or their punishment for neglect or refusal to attend in the courts of the United States.

- Note that Section 7 confers the power only on arbitrators and not on lawyers.
- Final thought: Is an arbitral subpoena enforceable beyond Rule 45’s territorial limits (cannot compel a non-party witness to travel beyond 100 “bulge” to give testimony). Courts are split (3<sup>rd</sup> and 8<sup>th</sup> have held that these subpoenas are not limited by Rule 45; a

different 3<sup>rd</sup> Circuit panel has held otherwise in a non-precedential opinion, as has at least one SDNY judge).

#### **IV. Should Depositions be Treated Differently from Documents?**

In my view, yes.

- Documents are necessary to build and prove cases.
  - Production of documents carries lowest burden.
  - Depositions are expensive, time consuming and burdensome, requiring multiple examinations of witnesses, once at the depositions and once at the hearings.
  - If depositions are included, is the proceeding really different than a litigation?
    - Still confidential.
    - Still able to choose arbitrators for industry expertise.
    - Parties still able to set the rules by their contract.
- BUT,**
- Practically full-blown litigation, plus significant arbitrator fees and forum fees.
  - Time consuming.
  - Expensive.
  - If parties have not agreed to it, and there is disparity of resources, less level playing field than court.
  - Arbitrators are not trained to handle discovery disputes, as judges are.
  - No rules to set standards for conduct.

#### **V. How Much Is Enough? How Much Is Too Much?**

As Judge Rakoff wrote in *Odfjell*:

“Arbitration, which began as a quick and cheap alternative to litigation, is increasingly becoming slower and more expensive than the system it was designed to displace, and permitting pre-hearing discovery of non-parties would only make it more so.”

*Odfjell ASA v. Celanese AG*, 328 F. Supp.2d 505, 507 (S.D.N.Y. 2004)

## **PART TWO: Appellate Issues**

### **I. Standards under FAA**

- The standards for vacating an arbitration award are few. FAA Section 10 lists the grounds, all of which would annul the very validity of the proceeding:
  - Where the award was procured by corruption, fraud, or undue means;
  - Where there was evident partiality or corruption in the arbitrators, or either of them;
  - Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
  - Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.
  
- The FAA also allows for modification for a mistake of calculation or description, imperfect form, or a ruling on a matter not affecting them.
  
- Manifest Disregard of the Law:
  - In 1953 the US Supreme Court added the Manifest Disregard standard in Wilko v. Swan, 346 U.S. 427, 436-37, 74 S.Ct. 182, 187-88, 98 L.Ed. 168 (1953).
  - Although the bounds of this ground have never been defined, it clearly means more than error or misunderstanding with respect to the law. Siegel v. Titan Indus. Corp., 779 F.2d 891, 892-93 (2d Cir.1985);
  - The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator.
  - The term "disregard" implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it. Bell Aerospace Company Division of Textron, Inc. v. Local 516, 356 F. Supp. 354, 356 (W.D.N.Y.1973), rev'd on other grounds, 500 F.2d 921 (2d Cir.1974).

## II. State Law

State laws vary, of course, and it is not possible to survey even a number of them, so allow me to look at one, New York, which illustrates an important difference from the FAA.

- Under New York law, there is no Manifest Disregard Standard, and the standard for mistake is arguably much higher.
- New York's Arbitration Statute allows vacatur only if:
  - The rights of a party were prejudiced by corruption, fraud or misconduct in procuring the award, or by the partiality of the arbitrator;
  - The arbitrator exceeded his or her power or failed to make a final and definite award; or
  - The arbitration suffered from an unwaived procedural defect.
- Even where the arbitrator makes a mistake of fact or law, or disregards the plain words of the parties' agreement, the award is not subject to vacatur "unless the court concludes that it is totally irrational or violative of a strong public policy" and thus in excess of the arbitrator's powers.

Hackett v. Milbank, Tweed, Hadley & McCloy, 86 N.Y.2d 146, 630 N.Y.S.2d 274, 654 N.E.2d 95 (1995).

## III. Overlay of New York Convention

The New York Convention provides that courts may refuse to recognize and enforce arbitration awards only in certain narrowly prescribed situations, all dealing with a panel exceeding its authority or the invalidity of the agreement:

- A party to the agreement was under some incapacity or the agreement was invalid under the law to which the parties have subjected it.
- A party did not receive proper notice of the appointment of an arbitrator, the arbitration proceedings, or was otherwise unable to present its case;
- The final award resolves a dispute not contemplated by the submission to arbitration or is beyond the scope of the submission to arbitration;

- The composition of the arbitral authority or the arbitral procedure was improper and not in accordance with the agreement of the parties;
- The award has not yet become binding or has been stayed by a competent authority.

9 U.S.C. § 201; New York Convention, Art. V (1).

Courts may also refuse to enforce the award if violates forum state's law:

- Matter not arbitrable under the law of the forum state.
- Award is contrary to public policy of forum state.

9 U.S.C. § 201; New York Convention, Art. V (2).

#### **IV. Is It Good Policy to Allow Court to Review Awards More Closely?**

I think that the dangers of doing so – that arbitration become just a private, more expensive and more multi-layered process than even American litigation -- outweigh the benefits of added scrutiny.

- As Third Circuit said in a prominent decision:
 

“A policy favoring arbitration would mean little, of course, if arbitration were merely the prologue to prolonged litigation. Nonetheless, inconsistent or incorrect rulings are possible in arbitration without any meaningful appellate review of the merits of an award; this is one of the risks parties must accept when choosing arbitration over litigation. A court may neither consider the disputants' arguments afresh, nor overturn a decision even should an arbitrator commit serious error.

Major League Umpires Ass'n v. American League of Professional Baseball Clubs, 357 F.3d 272 (3d Cir. 2004).

#### **V. Does Agreeing to Reasoned Decision Affect Appellate Rights?**

- Some parties think that requiring a reasoned award minimizes this risk. It certainly would give federal courts or state courts applying the FAA more to evaluate.
- Most major U.S. arbitration codes do not require a reasoned award:
  - **AAA: R-42. Form of Award**

(a) Any award shall be in writing and signed by a majority of the arbitrators. It shall be executed in the manner required by law.

(b) The arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate.

- **NASD: 10330. Awards**

(a) All awards shall be in writing and signed by a majority of the arbitrators or in such manner as is required by applicable law. Such awards may be entered as a judgment in any court of competent jurisdiction.

(e) The award shall contain the names of the parties, the name of counsel, if any, a summary of the issues, including the type(s) of any security or product, in controversy, the damages and other relief requested, the damages and other relief awarded, a statement of any other issues resolved, the names of the arbitrators, the dates the claim was filed and the award rendered, the number and dates of hearing sessions, the location of the hearings, and the signatures of the arbitrators concurring in the award.

- Is it asking for the Court to review the decision on some higher standard closer to an abuse of discretion standard?
  - Now asking court to pass on quasi-judicial decision of non-jurist, maybe even non-lawyer.
- Does the increasing prevalence of reasoned awards over the last 10 years or so encourage courts to look askance at awards that are not reasoned?
  - In vacating an arbitration award that it found to be incorrectly resolved, the Second Circuit took account of the lack of a reasoned opinion:
  - “At least in the circumstances here, we believe that when a reviewing court is inclined to hold that an arbitration panel manifestly disregarded the law, the failure of the arbitrators to explain the award can be taken into account. Having done so, we are left with the firm belief that the arbitrators here manifestly disregarded the law or the evidence or both.” Halligan v. Piper Jaffray, Inc., 148 F.3d 197, 204 (2d Cir. 1998)
  - The Court was quick to observe that it was not requiring reasoned awards:

- “We want to make clear that we are not holding that arbitrators should write opinions in every case or even in most cases. We merely observe that where a reviewing court is inclined to find that arbitrators manifestly disregarded the law or the evidence and that an explanation, if given, would have strained credulity, the absence of explanation may reinforce the reviewing court's confidence that the arbitrators engaged in manifest disregard.” Halligan, 148 F.3d at 204 (2d Cir. 1998).
  
- This may have been a good decision, but is it good for arbitration?