LIMITING DISCOVERY AND TESTIMONY IN ARBITRAIONS

By

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I. Introduction

There is general agreement that discovery is a major cost factor in arbitrations and that appropriate limits on discovery are necessary to make the process more efficient and less costly. Likewise, limits on testimony offered at the hearing are necessary to avoid redundancy and irrelevancy and to complete the hearing within the time period allocated. Arbitrators are sometimes concerned with their authority to enforce such limits and what standards they should use in doing so. The purpose of this article is to provide selected caselaw which illustrates such authority and standards.

II. Illustrative Case

Illustrative on both discovery and testimony is the recent case of *OneBeacon America Ins. Co. v. Swiss Reinsurance America, Corp.,* 2010 U.S. Dist. 136039 (D. Mass.) The issue in the arbitration was whether multiple non-products asbestos claims asserted against multiple policyholders could be aggregated by the cedent (One Beacon) into one occurrence in one year in order to exceed the retention necessary for a reinsurance recovery. In order to show industry custom and practice on point, "OneBeacon sought to take depositions from current and former Swiss Re employees, insurance and reinsurance agents, and others . . . ."[1] The panel allowed OneBeacon to depose one Swiss Re employee who was most knowledgeable about the treaty involved and the custom and practice as to the causative/aggregation issue. This witness testified that he was unaware of any custom and practice on point.

OneBeacon offered the testimony of a former senior executive of an intermediary as a fact witness to testify, among other things, on "his knowledge of the contract, including how it was intended to be applied, how it actually was applied, and how other reinsurers applied similar contract language."[2] However, the panel allowed him to testify only as to "what he saw, did or heard."[3] The panel accepted into evidence the written report of an expert retained by OneBeacon but declined to allow her to testify.

When the panel ruled against OneBeacon, it sought to vacate the award on the basis that it was denied a full and fair hearing. The court declined to vacate the award.

The court opened it's analysis with the observations that: (1) arbitration panels have considerable discretion in admitting evidence and structuring discovery; (2) not every failure to admit relevant evidence constitutes misconduct justifying vacation of a panel order; and (3) when the parties choose to have their dispute heard by an arbitration panel rather than a court, they give up certain procedural niceties normally associated with a court proceeding, such as discovery.[4] Turning to the facts of this case, the court noted that there was a three-day hearing with extensive testimony on both sides. Moreover:

> The Panel's actions do not rise to the level of misconduct, as there is nothing in the record to suggest that the Panel blocked OneBeacon's right to a full and fair hearing. Both of OneBeacon's witnesses were allowed to present the evidence they were competent to present. (The former intermediary), whom OneBeacon introduced as a fact witness rather than an expert witness, was allowed to testify as to matters of fact (that is, what he saw and heard) but not as to his opinions on the state of the industry. Similarly, (the expert) was allowed to testify on her experience with a similar treaty, but not on underwriting intent, an area in which she admitted to having no expertise.[5]

Another case involving disputes over discover and evidence admitted at the arbitration hearing is *Hunt v. Mobil Oil Corp. et al*, 54 F.Supp. 487 (S.D. N.Y.1987) *cert. denied* 393 U.S. 954 (1998). This was a massive arbitration which followed even more massive antitrust litigation. The panel: (1) denied discovery of certain documents; (2) excluded from evidence certain internal company documents which were made during the course of settlement negotiations; and (3) excluded from evidence certain affidavits. When the Hunts lost certain portions of the arbitration, they sought to vacate on the basis that the panel violated § 10(c) of the Federal Arbitration Act by "refusing to hear evidence pertinent and material to the controversy."

The court rejected the motion to vacate and several excerpts from the court's opinion are instructive:

> While the Court has found that the foregoing claims are without substance, it should be noted that even had there been erroneous rulings, these would not automatically bring into play that portion of 9 U.S.C. § 10(c) dealing with "misconduct [by the arbitrators] in refusing to hear evidence pertinent and material to the controversy." Only the most egregious error which resulted in adversely affecting the rights of a party would justify the application of the rule and require vacature.[6]
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> The Hunts' application to the arbitrators for production was a broad Federal Rules of Civil Procedure Rule 34 request. This type of request, which demanded documents of various types, is not uncommon in litigation, and it is frequently abused. It is precisely the type of production demand that is the exception rather than the rule in arbitration. If permitted, it would defeat the very purpose of arbitration.[7]

> With the massive evidence derived in the antitrust suit, and the additional documentary proof obtained as a result of Panel rulings, there is no rational basis for the Hunts' claim that the arbitrators were guilty of misconduct in refusing to issue a broadside subpoena "tantamount to a request for discovery." Fundamental fairness does not require that an arbitrator must hear any and all evidence a party may wish to offer, regardless of its length, repetiveness (*sic*) or irrelevance.[8]

III. Additional Caselaw on Failure to Allow Discovery

An arbitration over the terms of a coal sublease was the subject of *Louisiana D. Brown Irrevocable Trust v. Peabody Coal Co.,* 2000 U.S. App. 1909 (6th Cir). The panel decided the issue without discovery or an evidentiary hearing but after briefing and oral argument. The losing party asked the court to vacate the order based on misconduct under § 10(a)(3) of the FAA. The court declined to do so on the basis that arbitrators may have legitimately found that the sublease was unambiguous and that discovery would not have produced relevant and material evidence.

Roberts v. A.G. Edwards & Sons, Inc., 2007 U.S. Dist. Lexis 11853 (S.D.Tex) was an arbitration under the rules of the New York Stock Exchange for simplified arbitrations which did not require discovery or hearings. Two investors sought to recover against a dealer and the dealer sought discovery about the investors, their understanding of their investments, their level of sophistication and their damages. The arbitrator declined to order discovery and ruled for the investors based on written submissions. The dealer sought to vacate the award but the court declined to do so finding that there was no evidence that the lack of discovery or a hearing impinged on the fundamental fairness of the proceeding. The court stated: "For an arbitration to be fundamentally fair, the only requirements are that each party receive notice of the proceeding, that each party be given an opportunity to present material evidence and arguments to the arbitrators and that there be no bias on the part of the arbitrator or arbitrators."[9]

The arbitration panel awarded costs against Home in *Nationwide Mutual Ins. Co. v. Home Ins. Co.,* 278 F.3d 621 (6thCir.2001). Home argued that this was misconduct under § 10(c)(3) of the FAA since the panel did not allow discovery into Nationwide's list of its costs or a formal, oral hearing thereon. The court declined to vacate the panel order stating:

> Because Home received copies of Nationwide's submissions on the costs it incurred in defending against rescission, and the arbitration panel gave Home an opportunity to respond to these submissions, it is not clear what purpose discovery or a hearing on this issue would have served. At the very least, Home had notice of Nationwide's claims and an opportunity to present counter-arguments. We therefore conclude that the arbitration panel's procedure met the minimal standard of fundamental fairness.[10]

IV. Additional Caselaw on Excluding Testimony at the Arbitration

A. Cases Upholding Exclusion of Testimony

Newark Stereotypers' Union v. Newark Morning Ledger Co., 397 F.2d 594 (3rd Cir. 1968) was a labor dispute over the number of workers necessary to operate safely a casting machine. Pursuant to a collective bargaining agreement the union and employer entered into binding arbitration. After inspecting the machine in question, an expert for the union twice refused to give testimony but declined to give any reasons for this position. Later, however, he offered to testify but by this time the union no longer wanted his testimony and asked the panel to investigate whether he had been intimidated or induced not to testify by the employer. The panel declined to do so and ultimately ruled for the employer. The union sought to vacate the award on the basis of misconduct by the panel in refusing to hear evidence pertinent and material to the controversy.

The court declined to vacate the arbitration award. It observed that the panel was fully aware of the charges that the employer had interfered with the expert's testimony and consciously decided not to investigate, most likely because the panel had no general investigatory power to look into such matters. Moreover, it was a six week hearing with ample opportunity to present evidence:

> After [the expert] was excused, the union presented the testimony of two other expert stereotypers and was afforded ample opportunity to cross-examine the experts whom the company presented on its own behalf. It had four weeks after the [expert] incident during which the hearing continued, to procure other evidence if it deemed it necessary to do so. More fundamental even than this is the fact that the union itself refused to examine [the expert] when he announced his readiness to go forward as a witness after consulting with his independent counsel. . . .
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> In these circumstances, the case calls for the application of the principle that an award will not be vacated because of an erroneous ruling by the arbitrators, which does not affect the fairness of the proceedings as a whole.[11]

Generica Limited v. Pharmaceutical Basics, Inc., 125 F.3d 1123 (7th Cir.1997) was an arbitration between the parties to a pharmaceutical contract. Both parties presented extensive briefing and testimony to the arbitrator. The issue before the court was the cross examination of a third party witness. After an initial cross examination, the opposing party attempted to initiate additional cross examination which the arbitrator disallowed as he believed it to be collateral to the issue in the arbitration and which would have put the witness in legal jeopardy. Nonetheless, the arbitrator allowed the proposed area of cross examination to be otherwise developed in the record. The opposing party sought to vacate an adverse award on the basis of violation of fundamental due process requirements of the New York Convention

on Arbitral Awards. The court declined to do on the basis that the arbitrator's handling of the cross examination was proper and that the record fairly contained the contentions of the parties.

Two days before the hearing, and long after the close of discovery, one party added its CFO to its witness list and identified a number of new documents about which he would testify. *Commercial Risk Ins. Co. v. Security Ins. Co.,* 526 F.Supp.2d 424 (S.D.N.Y.2007). The panel heard extensive arguments concerning pertinence, materiality and import of the evidence offered by the CFO but chose to bar his testimony. The court found that this was well within the panel's authority given the factual circumstances. *See also Supreme Oil Co. v. Abondolo et al.,* 568 F.Supp. 401 (S.D.N.Y 2008) in which the court upheld a panel order barring the testimony of a party's counsel which was offered during the arbitration.

B. Caselaw Vacating on the Basis of Exclusion of Testimony

A labor dispute over attendance policy was at issue in *Westvaco Corp. v. Local 579*, 1992 U.S. Dist. Lexis 18206 (D.Mass.). Pursuant to the collective bargaining agreement, binding arbitration was initiated in the Springfield, Massachusetts plant. Before that arbitration was completed, the same issue was addressed in an arbitration ruling in the employer's Chicago plant. Thereafter, the Springfield arbitrator applied collateral estoppel to the Springfield arbitration to achieve consistency and declined to accept any evidence from the employer including evidence that the Chicago ruling was wrong and against legal precedent. The court vacated the award first noting that collateral estoppel is optional in an arbitration and that an arbitrator may accept a prior award because it is persuasive but not just for purposes of consistency. The court went on to rule that the arbitrator:

> (P)roceeded to exclude *every* piece of evidence offered by the employer, despite the fact that some of the evidence, at least, was highly relevant and probative on the question of whether the (Chicago) award was "clearly erroneous." When he decided to exclude the employer's submissions, he deprived himself of the evidence necessary for determining whether (the Chicago arbitrator) had interpreted the contract correctly. . . . This blanket exclusion of evidence was a procedural decision so aberrant that it deprived the employer of a fundamentally fair hearing.[12]

An arbitration with the union of an employee dismissed for indecent exposure was the subject matter of *Hoteles Condado Beach v. Union De Tronquist*, 763 F.3d 34 (1st Cir. 1985). The sole witness to the incident declined to testify when her husband was sequestered by the arbitrator pursuant to the motion of the union. In addition, the arbitrator accepted into evidence but gave no weight to the transcript of a criminal trial in which the sole witness testified and the individual in question was convicted. The arbitrator issued an order in favor the union due to lack of evidence. The hotel asked that the order be vacated under § 10(e) of the FAA for failure to consider relevant evidence. The court found that the

sequestration alone did not warrant a vacation of the order but that the failure to consider the criminal trial testimony did:

> The testimony was unquestionably relevant to a determination of whether Otero (the employee) actually engaged in immoral conduct in violation of the Company's disciplinary regulations. Moreover, no other evidence was available to substantiate or to refute the Company's charges that Otero had violated the rules regarding employment. The evidence effectively excluded by the arbitrator was both "central and decisive" to the Company's position; therefore, the arbitrator's refusal to consider this evidence was, as the district court concluded, "so destructive of [the Company's] right to present [its] case, that it warrants the setting aside of the arbitration award."[13]

Another case on point is *Tempo Shain Corp. et al v. Berteck, Inc.*, 120 F.2d 16 (2nd Cir. 1997). Wayne Pollock, the former president of Tempo Shain, was scheduled to testify in an arbitration but was unable to do so when his wife became seriously ill. He intended to testify concerning his own alleged misrepresentations and in support of a counterclaim for fraudulent inducement related to a transaction in which he was the sole negotiator on his side. The panel declined to postpone the hearing and Tempo Shain moved to vacate an adverse panel ruling on the basis of § 10(a)(3) of the FAA which deals with a panel improperly refusing to postpone a hearing. The court reviewed the record and determined that the testimony Pollock intended to give was: (a) not cumulative; and (b) critical to defending the misrepresentation claim by Berteck as well as Tempo Shain's counterclaim. On this basis, the panel's award was vacated.

V. Comments

Distilled to its essence, the message for arbitrators is that their awards will not be vacated for individual decisions concerning discovery or testimony, even if a reviewing court later considers them to be ill-advised. What is essential, however, is to allow the parties to present their position and essential evidence and argument supporting it. This is fundamental fairness.

ENDNOTES

[1] 2010 U.S. Dist. Lexis. 136039*9
[2] *Id.*12.
[3] *Id.*
[4] *Id.*6-7.
[5] *Id.*14.
[6] 654 F.Supp. 1487 at 1512.
[7] *Id.* at 1512-3.
[8] *Id.* at 1513.
[9] 2007 WL 597371 (S.D.Tex)*9.
[10] 278 F.3d 621 at 635.
[11] 397 F.2d 594 at 599-600.
[12] 1992 U.S. Dist. Lexis 18206*22(emphasis in the original).
[13] 763 F.2d 34 at 40 (internal citations omitted).