Depositions in Arbitration

The Pitfalls of Simplicity

By Charles F. Forer

This is the second in an ongoing series of articles that will provide franchise attorneys with practical advice about conducting arbitrations.

Hypothetical: Pupdog Limited, a franchisor of all things relating to puppies, is locked in a bitter dispute with a former franchisee. According to Pupdog’s attorney, “Luckily, the dispute is in arbitration. Reduces costs and expedites the result.”

You have to hand it Pupdog’s attorney. She not only drafted the arbitration provision, but also selected an arbitrator with extensive franchise experience and expertise who, to date, has seen eye-to-eye with Pupdog regarding the need for extensive discovery. Document requests, interrogatories, depositions — you name it; the arbitrator has allowed Pupdog to do it.

Over the objections of the former franchisee, for instance, the arbitrator allowed Pupdog to depose several third parties. “At last,” chortled Pupdog’s lawyer, “we will be able to demonstrate the franchisee’s fraudulent scheme that has siphoned lots of money offshore and reduced the franchisee’s monthly payments to Pupdog.”

Pupdog’s attorney recognized that she would need to compel those third parties to appear at deposition by means of a deposition subpoena. No problem. The arbitrator without fuss issued the requested subpoenas.

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After service of the first deposition subpoena, however, Pupdog’s attorney hit a snag when the third party moved to quash the subpoena. To make matters worse, the third party sought this relief in court — and not from the arbitrator who understood so well the need for the third-party deposition. Then, an even greater snag: The court granted the motion to quash the subpoena on the basis: “The Federal Arbitration Act does not authorize an arbitrator to subpoena a nonparty to testify at a deposition.”

Without the deposition of the third party, Pupdog will not be able to get to the bottom of the franchisee’s fraudulent scheme. And without getting to the bottom of the scheme, Pupdog’s case will fall apart.

Could Pupdog have avoided this result? Could it have convinced the court to deny the motion to quash and to enforce the subpoena?

SECTION 7 OF THE FAA

Section 7 of the FAA empowers arbitrators to summon a nonparty to appear “before them … as a witness.” 9 U.S.C. § 7. Many courts have stated that “before them” can mean only one thing — that arbitrators can issue a subpoena to a nonparty only to testify at an evidentiary hearing before the arbitrators. As the Third Circuit stated, in an opinion authored by then-circuit judge Samuel A. Alito: “The goals of arbitration are also relevant in determining the extent to which discovery is necessary in the current dispute over whether the parties are required to arbitrate. These goals include resolving disputes in a timely and cost-efficient manner and promoting judicial economy. Notably, discovery may serve to undermine the advantages offered by arbitration.” (citations omitted).

Do these rationales really make sense? As Pupdog’s attorney unsuccess fully argued in response to the motion to quash the subpoena:

Parties often choose arbitration for reasons other than efficiency and speed. Parties — including Pupdog — may want to take as much time and spend as much money as if they were in court. However, they may opt for arbitration in order to select an arbitrator with the expertise and experience to determine complex factual and legal issues. After all, arbitration is a matter of contract. Therefore, courts should not disregard the intent of parties who choose arbitration, not to save time or money, but instead to select a knowledgeable arbitrator. Courts should not tell the parties why they entered into their arbitration agreement; parties should tell the courts.

The court hearing the motion to quash flatly rejected Pupdog’s argument. But is the argument off base?

In his concurring opinion in Hay Group, Inc. v. E.B.S. Acquisition Corp., Judge Michael Chertoff noted that, under the FAA, an arbitrator has the power to issue a documents subpoena to compel a nonparty to produce documents before the arbitration hearing starts. “Arbitrators have the power to compel a third-party witness to appear before a single arbitrator, who can then adjourn the proceedings.” Id. at 413 (Chertoff, J. concurring); see also Alliance Healthcare Services v. Argonaut Private Equity, LLC, 804 F. Supp. 2d 808, 811 (N.D. Ill. 2011) (“In this case … [the arbitrating party] asked the arbitration panel to issue a subpoena for [third party] and its representative … to produce evidence and give oral testimony before one of the arbitrators. … FAA section 7 continued on page 4
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epressly allows subpoenas before just one of the arbitrators.

If an arbitrator can compel a non-party to produce documents before a single arbitrator, should an arbitrator likewise be able to compel a non-party to testify at a deposition before a single arbitrator? After all, the non-party producing documents and the non-party testifying at deposition are both appearing “before” the arbitrator “as a witness.”

In In re National Financial Partners Corp., 2009 U.S. Dist. LEXIS 34440 (E.D. Pa. April 21, 2009), the court adopted this very argument. There, a non-party sought to quash an arbitrator-issued subpoena compelling her to appear at a deposition before the arbitrator and before the arbitration hearing itself started. The arbitration hearing was to take place in Philadelphia, but the deposition of the third party was to take place in Florida. In denying the non-party’s motion to quash and her later motion for reconsideration, Judge John Fullam held that “[t]he arbitrator apparently has concluded that the third-party testimony is relevant and is important enough to warrant travel to Florida, and I see no basis to disturb that determination.” Id. at *1.

Convincing the Court

So there may be a way to convince a court to enforce an arbitration subpoena to compel a non-party to appear at a deposition. To increase the likelihood that the arbitrator and court will both accept this deposition-before-an-arbitrator theory, do the following:

• Ask the arbitrator to issue a prehearing subpoena to compel the non-party to appear at a deposition before the arbitrator.
• Summarize the anticipated deposition testimony to the arbitrator and to the court that considers the motion to quash the subpoena. Do not chant in talismanic fashion “relevant” and “material.” State in detail the reasons why this testimony is critical. Plus, set forth the hardships that your client would face if you were unable to depose the third party.
• Demonstrate to the arbitrator and the court that a prehearing deposition will not burden the non-party because the deposition will take place at a time and place that accommodates the non-party.
• Remind the arbitrator and the court that the alternative to the proposed third-party deposition — having the non-party appear at the arbitration hearing without a prior deposition — will prolong the hearing because the attorneys then must ask question after question as they seek to pin down the non-party. This will drive up everyone’s costs.

As Pupdog’s attorney confidently explained, “Next time, this will be a snap.” Some “snap”:

• What will Pupdog’s attorney do if she cannot convince the arbitrator or the judge that the non-party’s testimony is crucial?
• What will Pupdog’s attorney do if the arbitrator or the judge believes that arbitrating parties never should take depositions?
• What will Pupdog’s attorney do if her adversary and the third party both scream, “Delay, costly, inconvenient and burdensome”?

There is another consideration. Courts have refused to enforce non-party deposition subpoenas in order to minimize the costs and length of arbitration proceedings. However, a non-party deposition “before” an arbitrator drives up costs and delays the process; arbitrators are not cheap, and they are not instantly available, particularly if they have to travel to the location of the third-party deposition. By complying with the FAA to have non-parties appear as witnesses “before” one or more arbitrators, would Pupdog’s attorney be seeking a result that is more expensive and time-consuming than an old-fashioned deposition?

Of course, there is one other solution. Maybe Pupdog should reconsider whether it desires arbitration in the first place. See, e.g., Ware v. C.D. Peacock, Inc., 2010 U.S. Dist. LEXIS 44737, *10 (N.D. Ill. May 7, 2010) (“If C.D. Peacock wanted to have the option of third-party depositions, it should not have agreed to arbitration.”).

Disclose or Not  
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Doctors Express also asserted that disclaimers of liability in its FDD shielded it from the franchisees’ claims. The court ruled that such disclaimers could not be used to defeat the provisions of the Maryland franchise law or common law fraud, but, instead, could only be used to determine the reasonableness of this reliance by the finder of fact, thus precluding dismissal of claims at the 12(b)(6) stage.

Perhaps the most intriguing portion of the decision was the court’s denial of the motion to dismiss filed by the Doctors Express franchise broker. Rhino 7 argued that, as a mere broker, it had no knowledge of the alleged falsity of the representations made by Doctors Express in its earnings claim. The court ruled that, under Maryland’s franchise law, such a lack of scien-

ter is an affirmative defense and, thus, did not need to be alleged by the franchisees, but instead needed to be proven by Rhino 7 to avoid liability. However, under common law fraud rules, such a lack of knowledge needed to be proven by the franchisees. As such, the court granted Rhino 7’s motion to dismiss regarding the franchisees’ common law fraud claim, but upheld their Maryland franchise law claim.

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