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Epic Systems Corp. v. Lewis: The Reach of the FAA Remains Unchanged
By Sheila J. Carpenter – September 11, 2018

Epic Systems Corp. v. Lewis is the Supreme Court’s most recent exposition of the reach of the Federal Arbitration Act (FAA), 9 U.S.C. §1 et. seq. Authored by the Court’s newest justice, the opinion sounds an old theme—arbitration agreements must be enforced if the objection to arbitration is due to the nature of the arbitration rather than the traditional grounds for revocation of any contract.

Epic Systems Corp. v. Lewis, 138 S. Ct. 1612 (2018), took up the question of whether the right of employees under the National Labor Relations Act (NLRA) to bargain and act collectively made employment agreements specifying that only individual arbitrations might be brought an unfair labor practice. In an opinion authored by Justice Gorsuch, the Court held 5–4 that the NLRA should not be held to override section 2 of the FAA, which provides that arbitration agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” Justices Kennedy, Thomas, and Alito and Chief Justice Roberts joined in the majority opinion; Justice Thomas wrote a brief concurrence. Justice Ginsburg wrote a lengthy dissent, joined by Justices Breyer, Sotomayor, and Kagan.

The full text of section 2 of the FAA reads as follows:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

After defining “maritime transactions” and “commerce,” section 1 exempts certain contracts from the FAA: “[N]othing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.” In Circuit City Stores, Inc. v Adams, 532 U.S. 105 (2001), applying the maxim ejusdem generis, the Supreme Court held that “any other class of workers engaged in foreign or interstate commerce” referred only to workers in the transportation industries such as the seamen and railroad workers specifically referenced in the same clause and that other types of employment...
contracts are covered by the FAA. The dissenters in that case argued that section 1 was intended to exempt all employment contracts and that the FAA’s legislative history indicated that it was intended to cover only business disputes. The dissenters made this same argument in Lewis, continuing to maintain that the FAA was designed to cover only business-to-business disputes. The dissent goes so far as to compare employment agreements requiring individual arbitration to the “yellow dog contracts” used before the NLRA to require workers to agree not to join a union.

The dissent is heavily laden with policy arguments, particularly a concern with the perceived inequality of bargaining power between employer and employee and the disincentive to arbitrate on a solo basis for what may be relatively small sums. The opinion of the Court addresses these arguments at the outset:

Should employees and employers be allowed to agree that any disputes between them will be resolved through one-on-one arbitration? Or should employees always be permitted to bring their claims in class or collective actions, no matter what they agreed with their employers?

As a matter of policy these questions are surely debatable. But as a matter of law the answer is clear. In the Federal Arbitration Act, Congress has instructed federal courts to enforce arbitration agreements according to their terms—including terms providing for individualized proceedings. Nor can we agree with the employees’ suggestion that the National Labor Relations Act (NLRA) offers a conflicting command. It is this Court’s duty to interpret Congress’s statutes as a harmonious whole rather than at war with one another. And abiding that duty here leads to an unmistakable conclusion. The NLRA secures to employees rights to organize unions and bargain collectively, but it says nothing about how judges and arbitrators must try legal disputes that leave the workplace and enter the courtroom or arbitral forum.

Lewis, slip op. at 1–2.

The statutory analysis by the majority is largely textual, not looking outside the statutory language when such a view is not deemed necessary. Thus, Lewis not only provides insight into Justice Gorsuch’s view of the FAA but confirms what we can expect from him when the Court construes any federal statute.

The Court has held a number of times since Circuit City that section 2 of the FAA overrides the attempts of courts, legislatures, and agencies to limit arbitration and that various categories of disputes, such as consumer contracts, cannot be excluded. It has also held that arbitration
agreements can prohibit class arbitration. With these precedents, what was left to decide in Lewis?

*Lewis* arose from a peculiar administrative scenario. During the Obama administration, the National Labor Relations Board (NLRB) decided that employment agreements specifying that employees could bring only individual arbitrations constituted an unfair labor practice. Section 7 of the NLRA reads in part:

> Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection. . . .


The NLRB regarded the language referring to the right to “engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection” as including the right to bring collective or class actions. Once the Republican Party won the White House, the executive branch rejected the NLRB’s position; the Supreme Court received two briefs from the federal government, with the solicitor general and the NLRB espousing opposite positions on the issues.

_Sidelight:_ American workers have the right to join unions and bargain collectively. However, except in certain industries such as auto manufacturing, they largely do not exercise that right. A Bureau of Labor Statistics January 2018 report shows private sector union membership dipping below 7 percent in 2017. Had the NLRB succeeded in its argument that individual private sector workers seeking to bring class or collective actions are engaged in “concerted activities” within the meaning of the NLRA, it would have expanded its powers with respect to nonunion employers not currently subject to organizing efforts.

The employees involved in *Lewis* argued that section 7 of the NLRA made their restriction to solo arbitration “illegal” and that illegality is a ground for revocation of any contract. Justice Gorsuch rejected this argument because it contravened the direction of 9 U.S.C. § 2 that arbitration agreements may be invalidated only on the same grounds as would invalidate any contract. When an arbitration provision of a contract is singled out for invalidity, that is precisely what the FAA states cannot be done. This is the teaching of *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), another 5–4 decision (written by Justice Scalia) with the same justices dissenting as did in *Lewis*. “[C]ourts may not allow a contract defense to reshape traditional individualized arbitration by mandating classwide arbitration procedures without the parties’ consent.” *Lewis*, slip op. at 8 (citing *Concepcion*, 563 U.S. at 344–51).
The NLRB argued that its position was entitled to *Chevron* deference. See *Chevron USA v. Nat. Res. Def. Council*, 467 U.S. 837 (1984). However, the Court noted that the NLRB has no expertise with respect to the FAA and thus is not in a position to determine whether the FAA should be subordinated to the NLRA. The reconciliation of statutory conflict is a matter for the courts, not for administrative agencies.

The NLRB also argued that because the NLRA was passed several years after the FAA, there was an implied repeal of the FAA to the extent it could be read to allow arbitration agreements that prohibit collective claims. Justice Gorsuch cited precedent holding that the Court is reluctant to find that one statute invalidates an earlier statute absent an indication by Congress that repeal was intended, and he added:

> Respect for Congress as drafter counsels against too easily finding irreconcilable conflicts in its work. More than that, respect for the separation of powers counsels restraint. Allowing judges to pick and choose between statutes risks transforming them from expounders of what the law *is* into policymakers choosing what the law *should be*. Our rules aiming for harmony over conflict in statutory interpretation grow from an appreciation that it’s the job of Congress by legislation, not this Court by supposition, both to write the laws and to repeal them.

*Lewis*, slip op. at 10.

*Lewis* reiterates that when two parties agree to an arbitration clause, it will be enforced. Here the employees were told that if they did not agree to arbitration, they could quit. They chose to stay and thus were bound by the arbitration agreements their employers drafted. As in *Concepcion*, one party was free to say: “If you want to do business with me, you will agree to individual arbitration.” The choice to do business with the party insisting on arbitration is a choice to accept individual arbitration. *Lewis* makes clear that absent legislative action, the status quo will be maintained. The dissent’s vigorous denunciation of the Court’s two decades of precedent suggests that if the Court’s ideological makeup were to change, drafters of arbitration clauses would face a different landscape.

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Swimming Against the Tide? “Evident Partiality” of a Party-Appointed Arbitrator in the Second Circuit

By Conna A. Weiner – September 11, 2018

In an opinion that has inspired much discussion, the Second Circuit recently refused to vacate an arbitration award based on the “evident partiality” of a party-appointed arbitrator. In the process, the court defined a new, more forgiving standard for assessing nondisclosures by party-appointed arbitrators as compared with neutral arbitrators under the Federal Arbitration Act (FAA). Certain Underwriting Members of Lloyds of London v. Florida (Lloyds), 2018 WL 2727492 (2d Cir. 2018).

Summary of Lloyd’s

In Lloyd’s, Alex Campos, a party-appointed arbitrator, failed to disclose several contacts with ICA, his appointer. Perhaps the most serious was that Campos had been the president and chief executive officer of a human resources firm at the same time that Ricardo Rios, a director of ICA, was the chief financial officer of that firm. Rios was also a witness in the arbitration hearing.

The parties’ contract required that the arbitrators “be active or retired disinterested executive officers” from certain insurance companies and permitted party discussion with its party-appointed arbitrator before discovery. The proceeding was ad hoc.

The Second Circuit acknowledged the value of arbitrator disclosure and transparency and that, in failing to disclose his contacts, Campos had violated his ethical duties:

Mainstream arbitral guidelines such as ARIAS and the American Arbitration Association require comprehensive disclosure. . . . It would appear that Alex Campos violated these ethical codes; and future parties may well be wary of his participation on panels. However, it is well-established that such ethical violations do not compel vacatur of an otherwise valid arbitration award. . . . An arbitrator’s “failure to make a full disclosure may sully his reputation for candor but does not demonstrate evident partiality.” Sphere Drake Ins. v. All American Life Ins., 307 F.3d 617, 622-23 (7th Cir. 2002).

The court held that an undisclosed relationship between a party and its party-appointed arbitrator constitutes evident partiality if the undisclosed relationship clearly and convincingly (1) violates the arbitration agreement (here if it violated the contractual requirement of
disinterestedness) or (2) prejudicially affected the award. The Second Circuit remanded the case for findings under these standards. In effect, after Lloyd’s, barring a violation of the parties’ contract, a motion to vacate an award based on a party-appointed arbitrator’s failure to disclose may require actual proof that the nondisclosure skewed the award in favor of the arbitrator’s appointer.

To put this holding in context, it is useful to review the precedent that informed the court’s thinking.

**Supreme Court Precedent on Evident Partiality**

Fifty years ago, the U.S. Supreme Court addressed “evident partiality” in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968). An obviously aghast Justice Black, writing for a plurality of four justices, vacated an award where the third “supposedly neutral” member of an arbitration panel failed to disclose that one of his regular customers was one of the arbitration parties and that the party’s patronage of the arbitrator’s business was “repeated and significant” and “even went so far as to include the rendering of services on the very projects involved in this lawsuit.” Justice Black found that the provisions of the FAA regarding evident partiality and vacation of an award procured by “corruption, fraud, or undue means” showed a “desire of Congress to provide not merely for any arbitration but for an impartial one.” He went on to note that arbitrators should be held to an even higher standard than judges:

> It is true that arbitrators cannot sever all their ties with the business world, since they are not expected to get all their income from their work deciding cases, but we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review. We can perceive no way in which the effectiveness of the arbitration process will be hampered by the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias.

In an oft-cited concurring opinion, Justice White claimed to join Justice Black’s opinion with merely some “additional remarks” that a number of courts, including the Second Circuit, have essentially found irreconcilable with Justice Black’s viewpoint. Justice White stated that

> [t]he Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed of any judges. It is often because they are men of affairs, not apart from but of the marketplace, that they are effective in their adjudicatory function. . . . [A]rbitrators are not
automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial. . . .

Justice White declared that arbitrators “cannot be expected to provide the parties with [their] complete and unexpurgated business biography. But it is enough for present purposes to hold, as the Court does, that where the arbitrator has a substantial interest in a firm which has done more than trivial business with a party, that fact must be disclosed.”

Courts over the intervening decades have struggled to reconcile these opinions—often noting, as the Second Circuit has done, that the Commonwealth opinions were unclear or even irreconcilable—and have struggled to come up with a proper nondisclosure standard.

**Morelite: The Second Circuit’s “Have to Conclude” Standard**

In *Morelite Construction Corp. v. New York City District Council Carpenters Benefit Funds*, 748 F.2d 79, 83–84 (2d Cir. 1984), the Second Circuit vacated the award of a single arbitrator whose father was a senior executive for one of the parties because of the “inevitable” father-son loyalty, noting that standards for disqualification of arbitrators have been held to be less stringent than those of federal judges . . . [f]or to disqualify any arbitrator who had professional dealings with one of the parties (to say nothing of a social acquaintanceship) would make it impossible, in some circumstances, to find a qualified arbitrator at all. Mindful of the trade-off between expertise and impartiality, and cognizant of the voluntary nature of submitting to arbitration, we read Section 10(b) as requiring a showing of something more than the mere “appearance of bias” to vacate an arbitration award. To do otherwise would be to render this efficient means of dispute resolution ineffective in many commercial settings.

“Familiarity with a discipline often comes at the expense of complete impartiality [and] . . . specific areas tend to breed tightly knit professional communities,” the Morelite court flatly stated.

Nevertheless, the court acknowledged that it had a responsibility to “maintain the integrity of the federal courts’ role in affirming or vacating awards,” and in this regard, the court noted that although an “appearance of bias” standard was too low, proving “actual bias” was too difficult. Accordingly, the Second Circuit held that evident partiality within the meaning of 9 U.S.C. § 10, based on an undisclosed relationship, will be found.
where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration. In assessing a given relationship, the courts must remain cognizant of peculiar commercial practices and factual variances. Thus, the small size and population of an industry might require a relaxation of judicial scrutiny, while a totally unnecessary relationship between arbitrator and party may heighten it.

**Back to *Lloyd’s***

In *Lloyd’s*, the Second Circuit systematically laid out its understanding of the current state of the law in the circuit and identified the following principles.

**Neutral arbitrators.** The *Lloyd’s* court reaffirmed the *Morelite* “would have to conclude” standard and stated that the Second Circuit requires something more than the mere appearance of bias to vacate an arbitration award.

The court emphasized that it is the materiality of the undisclosed information, not the nondisclosure itself, that is important. It declared that the Supreme Court’s opinion in *Commonwealth* “established” that an arbitrator’s failure to disclose a material relationship with one of the parties can constitute “evident partiality” requiring vacatur of the award but does not establish a *per se* rule that requires an award to be vacated whenever an undisclosed relationship is discovered.

Even with respect to neutral arbitrators, the court said, “we have not been quick to set aside the results of an arbitration because of an arbitrator’s alleged failure to disclose information.” The court stated that it had concluded in several instances that the evident partiality standard was not satisfied because the complaining party should have known or could have learned of the relationship just as easily before the arbitration as after the party lost the case, as well as in situations where the undisclosed relationship was “too insubstantial to warrant vacating the award.”

In “broader strokes,” the court affirmed that the FAA does not proscribe all personal or business relationships between arbitrators and the parties.

The court also said it would not vacate an award when the party opposing the award “identifies no direct connection between the arbitrator and the outcome of the arbitration.”

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The court cited with approval the value of specialized arbitrators and opined that “[j]udicial tolerance of relationships between arbitrators and party representatives reflects competing goals in partiality decisions.” It noted that the best informed and most capable potential arbitrators may be repeat players with deep industry connections who will understand the trade’s norms of doing business and the consequences of proposed lines of decision, particularly where the parties regularly seek out such arbitrators.

**Party-appointed arbitrators.** Having outlined the standards for neutral arbitrators, the Lloyd’s court went on to discuss, and distinguish, the standards applicable to party-appointed arbitrators.

The court began by declaring that “the principles and circumstances that counsel tolerance of certain undisclosed relationships between arbitrator and litigant are even more indulgent of party-appointed arbitrators, who are expected to serve as de facto advocates,” citing with approval *Sphere Drake Insurance Ltd. v. All American Life Insurance Co.*, 307 F.3d 617 (7th Cir. 2002). The court also quoted a 1962 case for the proposition that “[i]here has grown a common acceptance of the fact that the party-designated arbitrators are not and cannot be ‘neutral,’ at least in the sense that a third arbitrator or judge is.” *Astoria Med. Grp. v. Health Ins. Plan of Greater N.Y.*, 227 N.Y.S. 2d 401, 404 (1962).

The court emphasized that arbitration is a creature of contract and that courts must hold parties to their bargain. The court stated that parties are free to choose for themselves to what lengths they will go in quest of impartiality, including the various degrees of partiality the court believed are part of the party-appointment procedure.

The court also approvingly cited several cases from other circuits holding that the disclosure requirements for neutral arbitrators do not extend to party-appointed arbitrators.

Although the court declined to “catalogue all material” undisclosed relationships that may “bear upon the service of a party-appointed arbitrator,” it did describe two circumstances under which such a relationship would be material: (1) the undisclosed relationship violated the arbitration agreement and (2) the party-appointed arbitrator’s partiality had a prejudicial effect on the award. With respect to the latter, however, the court cautioned that the alleged prejudicial effect needed to be clear:
In the absence of a clear showing that an undisclosed relationship (or the non-disclosure itself) influenced the arbitral proceedings or infected an otherwise-valid award, that award should not be set aside even if a reasonable person (or court) could speculate or infer bias.

Practice Points

*Lloyd’s* was decided in the context of the reinsurance industry and the specific qualifications the arbitrators were required to have. Although litigants no doubt will seek to distinguish *Lloyd’s* on this ground, the court did not so limit its holding, and counsel should assume it applies to all industries.

The Second Circuit’s general view that it is commonly expected that party-appointed arbitrators lack neutrality—and even have trouble playing a neutral role—has provoked the most controversy, and to this extent, the court would appear to be swimming against the tide. As commentators have noted, the “leading [domestic and international] arbitral rules, both in their latest versions and their earlier versions within the last 10 years or so, reflect the general practice that all arbitrators are expected to be neutral.” John Fellas, “Evident Partiality and the Party-Appointed Arbitrator,” *N.Y. L.J.*, June 27, 2018. For example, the commercial rules of both the American Arbitration Association (AAA) and JAMS in essence create a presumption that the arbitrators will be impartial or neutral and independent unless the parties explicitly agree that they will not be neutral (*AAA Commercial Rule 18; JAMS Rule 7*). The rules of the International Institute for Conflict Prevention & Resolution (CPR) flatly require that arbitrators serving on a CPR-administered or non-administered panel be “neutral and impartial.” (*Rule 7.1* (non-administered and administered rules)). In short, the prevailing contractual standards set forth in the provider rules presume or require neutrality.

In broader strokes, industry expertise in no way means that an arbitrator is incapable of conducting a neutral and balanced assessment of the case, and the ability to do this is generally expected of today’s arbitrators, party-appointed or otherwise. Nonetheless, as Mr. Fellas advises—and consistent with the Second Circuit’s emphasis on the importance of the parties’ bargain—it may be advisable for parties drafting arbitration clauses to consider providing specifically, where that is their intent, that all arbitrators are to be “impartial and independent” and for chairs to confirm this. In addition, contractually requiring the disclosure of all “material” or other relationships relevant to the parties may be advisable.
Even if the parties’ contract does explicitly permit partiality, however, the question remains whether the Second Circuit has inappropriately watered down the role of the FAA and the courts in supervising arbitration awards with its relaxed nondisclosure standard. Whether or not the Second Circuit struck the right balance will be debated for some time. In the end, given the lack of recent Supreme Court guidance and decisions such as *Lloyd’s*, it is absolutely critical for parties to address arbitrator qualification, disclosure, and impartiality requirements in their contract *ex ante* to ensure that they get the arbitration panel—and the efficient process free of one common source of post-arbitration litigation—that they want.

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Arbitrator Authority to Compel Production of Documents from Third Parties

By Sunu M. Pillai – September 11, 2018

Does an arbitrator possess the authority under Federal Arbitration Act (FAA) to compel production of documents from a third party prior to a hearing? The U.S. Court of Appeals for the Ninth Circuit has agreed with the Second and Third Circuits in holding that an arbitrator’s power to compel production of documents from a third party is limited to production at an arbitration hearing. CVS Health Corp. v. Vividus, LLC, 878 F.3d 703 (9th Cir. 2017). On the other hand, the Eighth Circuit has allowed arbitrators to order production of documents prior to the hearing, and the Sixth Circuit has indicated agreement with this position. The Fourth Circuit has stated that it may allow prehearing document production only under unusual circumstances.

Section 7 of the FAA

Section 7 of the FAA, 9 U.S.C. § 7, titled “Witnesses before arbitrators; fees; compelling attendance,” states:

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. . . . [I]f 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.

Courts that have limited the arbitrator’s power to production at an arbitration hearing have relied on the plain language of section 7 of the FAA. These courts have noted that this section of the FAA only allows arbitrators to compel third parties to “attend before them . . . as a witness” and to “bring with him or them” any documents “which may be deemed material as evidence in the case.” Thus, any document production by third parties can occur only before the arbitrator by a testifying witness.
Note that rules of arbitral associations (like the American Arbitration Association) may allow for arbitrators to issue subpoenas to third parties for documents. But if the third party refuses to comply with the subpoena, the party seeking discovery is limited to section 7 of the FAA to enforce the subpoena.

**Similarity with the Prior Version of Rule 45**

Courts have noted that the FAA was enacted at a time when prehearing discovery was generally not permitted. Rule 45 of the Federal Rules of Civil Procedure contained similar language from its adoption in 1937 until its amendment in 1991. *Hay Grp., Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404 (3d Cir. 2004). Rule 45 stated:

(a) For Attendance of Witnesses; Form; Issuance. Every subpoena shall be issued by the clerk under the seal of the court, shall state the name of the court and the title of the action, and shall command each person to whom it is directed to attend and give testimony at a time and place therein specified. The clerk shall issue a subpoena, or a subpoena for the production of documentary evidence, signed and sealed but otherwise in blank, to a party requesting it, who shall fill it in before service.

(b) For Production of Documentary Evidence. A subpoena may also command the person to whom it is directed to produce the books, papers, documents, or tangible things designated therein.


This was interpreted to mean that Rule 45 did not give the courts the power to issue subpoenas only for documents to third parties. The 1991 amendments authorized courts to issue a subpoena to compel document production by a nonparty, independent of a deposition. Courts have cited this amendment for the proposition that if Congress wants to expand the subpoena authority of arbitrators, it has the option to do so, similar to the amendment to Rule 45. *Life Receivables Tr. v. Syndicate 102 at Lloyd’s of London*, 549 F.3d 210 (2d Cir. 2008).

**An Alternative View—Implicit Power and Efficiency**

The Eighth Circuit has reached the opposite conclusion on policy grounds. *In re Sec. Life Ins. Co. of Am.*, 228 F.3d 865 (8th Cir. 2000). Similar to other courts, it noted that section 7 of the FAA does not explicitly authorize the arbitration panel to subpoena documents from a third party. However, it held that the power to subpoena documents prior to a hearing is implicit in the arbitrator’s power to subpoena documents at a hearing. It stated that the interest in efficiency in arbitration is furthered by permitting a party to review documentary evidence prior to a hearing. The Sixth Circuit has also favorably cited district court decisions holding that the
authority to compel the production of documents from third parties at an arbitration hearing implicitly includes the authority to compel the production of documents prior to the hearing. *Am. Fed’n of Television & Radio Artists, AFL-CIO v. WJBK-TV (New World Commc’ns of Detroit, Inc.)*, 164 F.3d 1004, 1009 (6th Cir. 1999).

The Fourth Circuit has indicated that a party might, under unusual circumstances, compel prehearing discovery upon a showing of special need or hardship. *COMSAT Corp. v. Nat’l Sci. Found.*, 190 F.3d 269 (4th Cir. 1999). It did not define “special need” but observed that at a minimum, a party must show that the information it seeks is otherwise unavailable.

Other courts have stated that the policy arguments cannot supersede the statutory text. Courts have noted that the principal goal of the FAA is to ensure judicial enforcement of private agreements, not efficiency. Third parties who have to produce documents pursuant to the subpoenas did not agree to the arbitrator’s jurisdiction. Further, having to appear at a hearing to receive documents may facilitate efficiency by reducing overall discovery in arbitration. Courts have also disputed the reasoning that the power to order prehearing document production is something lesser than the power to compel document production at a hearing and thus implicit.

**Workarounds**

As multiple courts have indicated, arbitrators can always compel any person to produce documents as long as that person is called as a witness at a hearing. Under section 7 of the FAA, arbitrators can compel a third-party witness to appear, with documents, before a single arbitrator, who can then adjourn the proceedings. *Hay Grp., Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404, 413 (3d Cir. 2004). This gives the arbitrators the practical ability to require third parties to produce documents in advance of a hearing. While this process may lead to additional discussions between the party requesting discovery and the arbitrators as to whether the document production is needed, it may also prompt the third-party witness to deliver the documents and waive appearance.

In instances where the third party from whom documents are being requested is not a party to the arbitration but is party to the arbitration agreement, formal joinder is another option that may enable the arbitrators to extend their contractual jurisdiction over the third party.
Conclusion
While a circuit split exists on the question of arbitrators’ authority to compel prehearing document production from third parties, all of the recent decisions have held that arbitrators do not have such authority under section 7 of the FAA. This may not be a real constraint as there are workarounds to compel document production that comply with FAA. At the same time, the additional effort required for these procedures may prompt the parties to reexamine the need for discovery, leading to a more efficient process.

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Fourth Circuit: Active and Protracted Litigation of Claims Waives Compulsory Arbitration

By Quinton M. Herbert – September 11, 2018

On January 18, 2018, the U.S. Court of Appeals for the Fourth Circuit held that when a party to an arbitration agreement actively and substantially participates in prolonged litigation, it waives its right to compulsory arbitration under the agreement. In Degidio v. Crazy Horse Saloon & Restaurant, 2018 WL 456905 (4th Cir. Jan. 18, 2018), the Fourth Circuit upheld the lower court’s decision denying Crazy Horse Saloon and Restaurant’s (Crazy Horse) motion to compel arbitration in a suit alleging violations of the Fair Labor Standards Act (FLSA) and state employment laws. The court essentially held that the Crazy Horse’s participation in litigation for over three years before filing a motion to compel arbitration severely prejudiced the plaintiffs and consequently its right to compulsory arbitration was waived. In very interesting dicta, the court indicated that the arbitration agreements were also invalid because they were presented under circumstances that were “ripe for duress.” However, the court stopped short of analyzing the arbitration agreement under the contract principle of unconscionability.

Facts and Procedural Background
Alexis Degidio, the named plaintiff and appellee in the case, performed as an exotic dancer at Crazy Horse Saloon from 2012 through 2013. Degidio and other adult entertainers were classified as independent contractors and were not considered by Crazy Horse to be employees. Consequently, adult entertainers like Degidio were not paid a minimum wage and were compensated only through customer tips. In early August of 2013, Degidio filed a putative collective action, pursuant to the FLSA. The suit alleged that Crazy Horse misclassified adult entertainers as independent contractors in violation of the minimum wage and overtime provisions of the FLSA. Degidio also filed similar state law claims under the South Carolina Payment of Wages Act, S.C. Code § 41-10-10 et seq. Soon thereafter, other adult entertainers joined the suit. It is worth noting that, at the time the suit was initially filed, none of the adult entertainers had executed arbitration agreements with Crazy Horse.

On October 8, 2013, Crazy Horse filed an answer to Degidio’s complaint. The parties subsequently participated in discovery for over a year. In November and December 2014, more than 15 months after the initiation of Degidio’s case, Crazy Horse began entering into arbitration agreements with entertainers who worked at the club. Crazy Horse placed the arbitration clause in a lease distributed to adult entertainers who used its facilities. Crazy Horse also told performers that the only reason that they could keep tips and create their own schedules was because they were independent contractors. Crazy Horse required entertainers
to sign the lease and arbitration agreement, which also prohibited filing a class action against Crazy Horse or joining the Degidio suit, as a condition of performing at the club. Crazy Horse initiated the arbitration agreements without notifying the district court that it was contacting potential class members about the litigation.

In December 2014, Crazy Horse moved for summary judgment on all claims. In its motion, Crazy Horse did not raise arbitrability, nor did Crazy Horse file a motion to compel at this juncture. The motion for summary judgment was strictly on the merits of the case and contended that the adult entertainers were properly classified as independent contractors. At the same time that Crazy Horse filed its dispositive motion, Degidio moved for Rule 23 class certification for the state law claims and conditional certification of a collective action under the FLSA. A month after that, Crazy Horse filed an opposition to the class certification and, for the first time, filed a motion to compel arbitration against adult entertainers who had signed the lease agreements that contained the arbitration agreement.

The trial court granted in part and denied in part Crazy Horse’s motion for summary judgment. Ultimately, the trial court ruled that the dancers were employees under the FLSA. At the same time, it raised concerns about the enforceability of the arbitration agreements. Finally, the trial court granted Degidio’s motion for conditional certification of an FLSA collective action and authorized her to contact potential plaintiffs. Shortly thereafter, new plaintiffs joined the suit. Nine of the new plaintiffs had executed the arbitration agreement. Consequently, the club filed a new motion to compel arbitration against dancers who had opted into the case since the court denied its first motion to compel. The new motion was filed more than three years into litigation and more than nine months after the last plaintiff opted into the action. Moreover, significant discovery was conducted, and the court had ruled on several dispositive motions and certified several state law questions. The new motion to compel was ultimately denied. Crazy Horse noted an appeal from this decision.

On appeal, the issue before the court was whether an arbitration agreement executed more than a year into a class action suit can be enforced against new members of the class who signed the agreement.

The Fourth Circuit’s Ruling
Under the Federal Arbitration Act (FAA), an arbitration agreement will be enforced unless it can be invalidated on such grounds that exist at law or in equity for the revocation of any contract. Nonetheless, it is well established that rights provided by a contract can be waived. This includes the right to compulsory arbitration under an arbitration agreement. Under federal law, a litigant effectively waives its right to compel arbitration when it “so substantially utilize[s] the
litigation machinery that to subsequently permit arbitration would prejudice the party opposing the stay.” *Fraser v. Merrill Lynch Pierce, Fenner & Smith, Inc.*, 817 F.2d 250, 252 (4th Cir. 1987).

The Fourth Circuit acknowledged the FAA’s “liberal federal policy favoring arbitration agreements.” However, the court recognized that the FAA is not without limitation. The court held that a party can waive its right under the FAA to compulsory arbitration if the litigant uses the litigation process and allowing arbitration would prejudice the opposing party. To determine whether the opposing party was prejudiced, the court considers two factors: “1) the amount of the delay; and 2) the extent of the moving party’s trial-oriented activity.” *Stedor Enters., Ltd. v. Armtex, Inc.*, 947 F.2d 727, 720 (4th Cir. 1991).

The court concluded that Crazy Horse pursued a merit-based litigation strategy for over three years, filing multiple dispositive motions and engaging in protracted discovery. The court indicated that both the district court and the plaintiffs had spent considerable time and resources on the same issues that would be reconsidered by an arbitrator. The court also noted the potential public policy implications of allowing a party to wait until a class is certified to move to compel arbitration and the potential adverse effect such a course of action could have on future claimants in class action litigation.

The court next turned its attention to the purposes of arbitration under the FAA. The court noted that had the district court granted Crazy Horse’s motions for summary judgment, the need for arbitration would have been moot. Thus, the court reasoned, Crazy Horse was not seeking to use arbitration as an alternative to litigation; instead, Crazy Horse was seeking to use arbitration as “a second bite at the apple” to avoid liability, a purpose that runs afoul of the FAA.

Finally, in very interesting dicta, the court indicated that the arbitration agreements were invalid because they were presented under circumstances that were “ripe for duress.” However, the court stopped short of finding that the arbitration agreements were unconscionable.
Conclusion
Employers should consult with legal counsel and develop viable arbitration agreements for independent contractors in advance of litigation. In addition, any subsequent implementation of arbitration agreements as a result of litigation should be vetted by counsel and signers should be informed in the agreement of their option to seek independent legal counsel or waive that option and sign without legal review.

Quinton M. Herbert serves as the deputy labor commissioner for Baltimore, Maryland. The views of the author and publication do not reflect those of and may not be imputed to the author’s employer.
The Difference Between Litigation Advocacy and Mediation Advocacy

By Edmund J. Sikorski Jr. – September 11, 2018

Litigators are highly focused on one thing—litigation. This includes document as well as electronic data review gleaned through both the investigative and litigation discovery process. The focus is on the development of answers to the question of what happened. The material must be sorted through and a liability theory developed.

Next comes garnering, developing, and marshaling evidence often including expert opinion and testimony to support or refute the liability theory. The focus of this material is on how it happened and why it happened.

Next, efforts are focused on how the relevant material can be presented to the target audience to achieve the desired reaction and outcome. The object is to convince the trier of fact of the righteousness of the client’s position.

In the process, evidentiary objections must be identified, anticipated, and if possible, overcome. Strict compliance with the rules of discovery, rules of evidence, and trial scheduling orders is strategically important because it will determine what the trier of fact will hear in reaching a decision.

In this combat environment, it is not uncommon and is very natural for hard-nosed positions to develop as the focus on a litigated conclusion to the conflict intensifies. Tensions, conflicts, and enmities may erupt that challenge the concept of civility.

The very nature of the process creates at least three cognitive impediments that directly affect the assessment of conflict resolution options and ranges of settlement value:

1. Advocacy bias—spending too much time identifying one’s strengths but paying insufficient attention to one’s weaknesses.

2. Cognitive dissonance—failing to consider data contradicting one’s viewpoint.

3. Certainty bias—overestimating assessments of probable litigation outcomes.

The enthusiasm generated by this process can be contagious to the client and may be difficult to justify modifying at a later date without having the client raise questions that will cause counsel to cringe.
However, we know that 98 percent of all litigation will settle at some point before the terrifying words “Call the jury” are uttered. That fact proves that when someone else is about to impose a decision, the combatants suddenly become more willing to find an answer themselves.

It also means that at some point the risk-taking inherent to litigation probably will pause and serious consideration will be given to measuring the risks of trial against the benefits of attaining a resolution that may not be ideal but will meet the client’s needs.

This new case analysis demands a skill set that is dramatically different. It is called mediation advocacy. It can be thought of it in terms of the saying, “We do not ask generals to be diplomats or diplomats to be generals.”

For example, generals (litigation advocates) are not distracted from engagement by stopping to consider (mediation advocacy) how to make a principled first offer to end the conflict, and diplomats (mediation advocates) do not plan for the next assault to defeat and eliminate the opposition.

Mediation advocacy focuses on soliciting the cooperation of the opposing party by finding common ground instead of asserting positions. Success depends on the opposing party accepting the resolution sought. So taking an extreme position is unlikely to be successful.

The language chosen, the presentation made, and the approach must change from military tactics to diplomatic maneuvering. The goal changes to obtaining a mutually acceptable result regardless of the stated positions of the parties. Attention is centered on the elements of risk analysis and costs (monetarily as well as emotionally).

Mediation advocacy does not include telling the other side what you will do to beat them at trial. Never expect that adversarial approach to be persuasive. Likewise, an indelicate presentation of the strengths and weaknesses of the other side’s case may entrench that side in the overconfidence biases identified above. The best mediation advocacy consists of a calm and even-handed presentation of the arguments you expect to make in court, the documents you intend to introduce, summaries of any expert testimony, and the principled explanation of the relief sought and why it is reasonable. Hearing an adversary calmly state his or her case can often persuade the listener that the speaker’s case is stronger than the listener anticipated, thus reducing the listener’s level of confidence in his or her own success in court.

Mediation advocacy is simply the developed art of persuasion. The other side must be persuaded that it is in its best interests to settle the dispute on your suggested terms.
This skill set was first described by Aristotle 2,400 years ago:

Of the modes of persuasion furnished by the spoken word there are three kinds. The first depends on the personal character of the speaker; the second on putting the audience into a certain frame of mind; the third on the proof, or apparent proof provided by the word of the speech itself.

First, the mediation advocate must have command of both the law and facts of the case from both sides of the table. While it is presumed that the applicable law will control, it may be surprising to find that the law relating to the subject may have little to do with the terms of dispute resolution because of the underlying interests of one or both disputants. Boisterous, bombastic denunciations will almost always backfire. Treating people with disrespect, even when their stories verge on the fanciful, is normally counterproductive.

Second, the decision makers on the other side will be the first jurors. They are the intended audience.

Appeal is made to the inherent human emotions along five general themes:

1. Care or harm
2. Fairness or cheating
3. Loyalty or betrayal
4. Authority or subversion
5. Sanctity or degradation


Every legal case will contain one or more of these themes. If employed in the mediation presentation, they will have the identical effect as in an opening statement to the jury. Research by social scientists indicate that 60 to 80 percent of jurors make up their minds about which side’s story is the truth after opening statements. First impressions are often lasting impressions.

Third, proof, or apparent proof, is largely a function of presentation. Apparent proof is clear, plain, and evident. A picture is worth a thousand words because seeing is believing.

Aristotle only had oratory and perhaps a few drawings to instill mental images in the minds of his audience; 2,400 years later, we have not only pictures, photographs, and dramatizations but also animations to carry the motivational theme embedded in presentations. Use of imagery is an absolute necessity in persuasive presentations.
Conclusion

Is the goal a litigated conclusion or a negotiated conclusion? A litigated conclusion is not the same as cutting a business deal that considers and weighs the often unspoken and far-reaching interests and objectives of the client and involves the client directly in the decision-making process. Effective litigation advocacy concentrates on a contested result and is not distracted by a concerted effort to focus on compromise resolution.

In contrast, effective mediation advocacy concentrates on the choice of words, the manner in which they are delivered, and a presentation that will give the opposing party a reason to reconsider its position and cooperate in reaching a resolution without trial.

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PRACTICE POINTS

Delegation Clause in Insurance Contract Is Void under Virginia Law
By Mengru Song – August 29, 2018

Under Virginia law, an arbitration agreement in an insurance agreement is void, and insurers cannot compel a policyholder to arbitrate insurance disputes. Va. Code § 38.2–312. Insurers cannot circumvent Virginia law by providing that an arbitrator has exclusive authority to decide arbitrability, because the Fourth Circuit recently has held that such a delegation clause is void. Minnieland Private Day Sch., Inc. v. Applied Underwriters Captive Risk Assurance Co., Inc., 867 F.3d 449, 453 (4th Cir. 2017).

In 2013, Minnieland Private Day School (Minnieland) entered into a “Reinsurance Participation Agreement” (RPA) with Applied Underwriters Captive Risk Assurance Company (Applied) as part of Minnieland’s purchase of Applied’s workers’ compensation program. The RPA entitled Minnieland to share in the profits and losses attributable to Minnieland’s policies. The RPA provided that “[a]ll disputes between the parties relating in any way to (1) the execution and delivery, construction or enforceability of this Agreement, (2) the management or operations of the Company, or (3) any other breach or claimed breach of this Agreement” were subject to mandatory binding arbitration.

After paying its premiums for 33 months, Minnieland was billed a monthly premium that was 1,167 percent higher than the previous month and 801 percent higher than the average premium that it had paid before. Minnieland paid this unusually large bill, but it did not pay the similarly large bill for the following month. Applied responded by terminating Minnieland’s worker’s compensation policy and billing it for the outstanding balance.

In December 2015, Minnieland sued Applied for its noncompliance with Virginia insurance and workers’ compensation laws. Of particular note here, Minnieland alleged that RPA constituted an insurance contract, not a reinsurance contract, and that under Virginia law, the arbitration provision in the RPA was invalid. Applied moved to compel arbitration, arguing that the delegation clause in the RPA gave the arbitrator exclusive authority to decide arbitrability, including whether the RPA was or was not an insurance contract subject to Virginia law.
In making this argument, Applied relied on the Supreme Court’s decision in Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63 (2010) which held that a delegation clause authorizes arbitrators to decide questions of arbitrability and that, unless the delegation clause is specifically challenged, the court should send the case to the arbitrator to decide. Minniedland had not challenged the delegation clause, so Applied argued that the case should be sent to arbitration. The Fourth Circuit disagreed. It held that the entire arbitration agreement, including the delegation clause, was void under Virginia law “from its inception . . . .” Accordingly, “the delegation provision – an additional, antecedent agreement to arbitration – [also was] unenforceable from its inception.” The Court also stated that Virginia law gives the insured the right to resolve insurance disputes in court and that allowing an arbitrator to decide whether the contract was an insurance agreement would undermine Virginia law.

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Mississippi Supreme Court Rejects Trial Court’s Modification of Award
By Katharine Kohm – August 23, 2018


In D. W. Caldwell, Inc. v. W.G. Yates & Sons Constr. Co., No. 2017-CA-00116-SCT, 242 So.3d 92 (Miss. May 10, 2018), the Mississippi Supreme Court considered a trial court’s modification of an arbitration award on the grounds of “evident miscalculation.” The supreme court reversed,
holding that modification was improper because the error was not “apparent from face of arbitration award.” *Id.* at 99.

In *Caldwell*, the underlying dispute concerned a roofing subcontract for a dormitory at Auburn University. After starting work, the subcontractor discovered structural issues. The subcontractor made the structural repairs and completed the roofing, but it was not fully paid. The dispute was submitted to arbitration, and the arbitrator issued a reasoned award in the subcontractor’s favor. The general contractor requested clarification from the arbitrator, which was denied, and then moved to alter, amend, or vacate the award in court.

In Mississippi, the grounds to amend or correct an award are “an evident miscalculation of figures or an evident mistake in the description of any person, thing or property referred to in the award; (b) The arbitrators have awarded upon a matter not submitted to them and the award may be corrected without affecting the merits of the decision upon the issues submitted; or (c) The award is imperfect in a matter of form, not affecting the merits of the controversy.” Miss. Code. Ann. § 11-15-135.

The trial court denied the subcontractor's motion to confirm and instead allowed the general contractor to introduce evidence and testimony as to the alleged miscalculation. The trial court held that there was a “facially evident miscalculation” because “the arbitrator had duplicated the labor costs for shingle installation in its award—one under the original subcontract and once under the oral agreement to repair the structural damage.” To correct this error, the trial court reduced the award by $104,507.

On appeal, the Mississippi Supreme Court reversed. It held that the “award contained no evident miscalculations which would merit modification.” The court first focused on the extreme narrowness of arbitration review but acknowledged that the court had not previously defined what qualified as an “evident miscalculation.” After reviewing cases from other jurisdictions, it settled on this definition: an “evident (plain, obvious, or clearly understood) miscalculation must be apparent from nothing more than the four corners of the award and the contents of the arbitration record.” The moving party must show “[w]ithout looking outside the undisputed facts or relying upon testimony from a witness in the trial court” that “a different, but correct, calculation could be made.” The court examined the “award for any facially evident miscalculations or computational errors,” but found none. Looking next to the attorney-written arguments, oral arguments, and agreed-upon record evidence, [it] likewise failed to find such errors.”
After reaching this holding, the court also stated that the trial court abused its discretion by hearing and crediting witness testimony during the award modification hearing. The court emphasized that “arbitration is meant to supplant litigation, not supplement it” and that the trial court’s error “transformed . . . the very narrow and limited purpose of its review, and [instead impermissibly] imbued it with the responsibility of the factfinder.”

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