



Interpreting the Federal Arbitration Act: May an Arbitrator Issue a Prehearing, Nonparty Subpoena?

By Lisa Colon Heron and Justin S. Wales



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The age-old tenet that “time equals money” is never truer than when speaking of litigation. As the costs associated with litigation have skyrocketed, alternative dispute resolution has become the favored method of resolving cases in the construction industry. The rationale underlying alternative dispute resolution is that, by allowing parties to contract themselves out of the courtroom, we allow them to avoid all of the inefficiencies that go along with being inside the courtroom. We are, in other words, allowing the parties to contract the right to control their case. Arbitration promises such control and has become the standard method of resolving construction disputes.

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Through a streamlined discovery process, accelerated hearing schedule, and the ability to have a case heard by arbitrators sophisticated in the disputed subject matter, arbitration offers the parties involved a cheaper, more efficient alternative to traditional litigation.

A problem arises when a nonparty possesses information needed by a party to develop its case. Imagine a scenario common to construction disputes: A property owner hires a general contractor to complete a large-scale renovation project on an existing office building. The general contractor hires subcontractors

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Unresolved Legal Issues with Modified Total Cost Claims

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The modified total cost (MTC) claim has developed case by case without a comprehensive assessment of several key issues that affect its utility and applicability in the face of other established principles of construction law. This article generally traces the different approaches to the MTC

claim under state and federal law, and then explores some of the more problematic issues not yet authoritatively discussed in either forum. Because an MTC claim is truly nothing more than a modified version of a total cost claim, it is

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to compel the contractor to follow the change order requirements. “Waiver” is traditionally a difficult concept to prove because it involves the “knowing” and “intentional” relinquishment of a specific right set forth in the contract. Accordingly, a contractor should generally not assert a “waiver” response unless there is clear evidence (such as a written waiver) that the owner intended to waive its right to the change order requirements.

Construction Damages

The final eight instructions address issues specific to construction-related damages. For example, CACI section 4544 provides that in certain circumstances, where the owner breaches its contract with the contractor by delaying, disrupting, or interfering with the contractor’s work, the contractor can recover its lost profits in addition to the other damages caused by the owner’s breach. To recover its lost profits, the contractor must show that it reasonably would have earned the alleged lost profits had it not been for the owner’s breach. The contractor must also demonstrate that at the time of contracting, it was reasonably foreseeable that the contractor would have earned those profits. Accordingly, a contractor should always be aware of how the acceptance of one job affects other jobs passed up as a result.

Conclusion

The instructions discussed above are only a few of the 18 that were officially adopted in California, which can serve as a resource to contractors nationwide. Even though the rules may vary in name from state to state, the basic principles of law are similar throughout the nation. In addition, as more states attempt to make complicated construction law principles easier for the jurors to understand, they are likely to adopt instructions similar to those in California.

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Interpreting the Federal Arbitration Act

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and sub-subcontractors to work on various aspects of the project. The project suffers from the usual hurdles of large-scale construction projects—delays, setbacks, changes in the scope. A dispute arises between the general contractor and the property owner over the total

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amount owed to the general contractor. The contract between the general contractor and the property owner contains an arbitration clause. To develop its case, the general contractor must review documents maintained by the subcontractors and sub-subcontractors. In normal litigation, these records would be easily obtained during the discovery process; however, because arbitrations are contracts, and parties to a contract can only bind themselves, the power to enforce a subpoena on a nonparty is limited by statute. At the federal level, that statute is the Federal Arbitration Act (FAA). 9 U.S.C. § 7. A federal court’s power to enforce nonparty subpoenas under the FAA is debated.

Through the examination of the numerous, contradictory Federal Circuit Court of Appeals decisions, this article presents an overview of the current status of the law and explores whether the possible inability

of federal court enforcement of such subpoenas under the FAA abrogates the very notion of efficiency that makes arbitration such an attractive alternative to litigation.

An Implicit Right?

The plain language of section 7 of the FAA appears to grant only arbitrators the authority to order nonparty production of documents *at the time* of the witness’s appearance at the hearing:

The arbitrators selected . . . 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. . . . Said summons 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.

9 U.S.C. § 7.

Arbitrations typically involve one final arbitration hearing on the issue. Under the language of the statute, it appears that an arbitrator is powerless to require nonparty document production *before* that final arbitration hearing. The FAA’s silence on the issue of subpoenaing power prior to an arbitration hearing has been interpreted by a number of courts to restrict the power of an arbitrator to

issue such subpoenas. The Second and Third Circuit Courts of Appeals take such a view and have refused to read any implicit right to compel prehearing document production from nonparties into the statute. While this view may be proper under a restrictive view of statutory interpretation, it ignores the fact that prehearing discovery is often a crucial means of developing one's case and integral in keeping the arbitration process efficient. Acknowledging such realities, some courts, such as the Eighth Circuit Court of Appeals, have ignored the silence of the FAA and instead have read into the statute the right to enforce prehearing subpoenas on nonparties.

A Nuanced Approach?

The Second, Third, and Eighth Circuit Courts of Appeals are not the only courts to have spoken on the issue of an arbitrator's subpoenaing power under the FAA, but they do represent the most extreme views. In contrast, the Fourth Circuit Court of Appeals, the first appellate court to rule on this problem, has adopted the most nuanced approach to the issue. In *COMSAT Corp. v. National Science Foundation*, 190 F.3d 269 (4th Cir. 1999), the court held that while the FAA did not explicitly allow prehearing, nonparty discovery, it was nevertheless acceptable to permit the enforcement of prehearing document subpoenas if the requesting party could show a "special need or hardship." *Id.* at 275. The court, in that case, refused to enforce the arbitrator's subpoena but nevertheless found that even though a literal reading of the FAA supported limited discovery, a characteristic that has become a hallmark of modern arbitration, situations existed in which such limited discovery would produce inefficiencies that undermined the "policy underpinnings of arbitration." *Id.* at 276. The Fourth Circuit's decision in *COMSAT* appears to signify a rational, case-by-case approach to enforcing prehearing, nonparty subpoenas, but the court's failure to define what kind of "special need or hardship" warrants the

enforcement of a prehearing, nonparty subpoena puts the evenhandedness of the court's decision into question. The court's silence on the issue has continued for the past 12 years, effectively mooting the exception it purports to create.

Expanding the Arbitrator's Subpoenaing Power

When this issue reached the Eighth Circuit in 2000, that court took an

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expansive view on an arbitrator's powers to issue prehearing, nonparty subpoenas. In *In re Security Life Insurance Co. of America*, 228 F.3d 865 (8th Cir. 2000), the court held that arbitral efficiency dictated that arbitrators have the power to issue prehearing, nonparty subpoenas. The issue before the court was whether a nonparty insurer must respond to a subpoena issued by an arbitrator overseeing a reinsurance dispute between several insurers. The court, while recognizing that the FAA "does not . . . explicitly authorize the arbitration panel to require the production of documents for inspection by a party," nonetheless held that the insurer must comply with the subpoena. Noting that the party whose documents were requested was also a party to the original insurance contract, and thus "not a mere bystander," the court held it would be inefficient, and thus against the policy underlying arbitration, not to

enforce the arbitrator's subpoena. *Id.* at 870-71.

While it is likely under the Eighth Circuit's decision that subcontractors would also be considered more than "mere bystanders" to a contract, the "mere bystander" test may not be necessary for an arbitrator within the Eighth Circuit to issue a nonparty subpoena. The court in *Security Life* took an even more expansive view, rejecting any type of relational test and instead giving outright approval of nonparty subpoenas. "Although the efficient resolution of disputes through arbitration necessarily entails a limited discovery process," the court noted, "we believe this interest in efficiency is furthered by permitting a party to review and digest relevant documentary evidence prior to the arbitration hearing." *Id.*

The Eighth Circuit's *Security Life* decision is the only appellate court decision that directly takes such an expansive view of an arbitrator's power to issue prehearing, nonparty subpoenas. The Sixth Circuit, however, has indicated that it may be in agreement with its sister circuit. In *American Federation of Television & Radio Artists v. WJBK-TV*, 164 F.3d 1004 (6th Cir. 1999), the court upheld a labor arbitrator's subpoena issued to a nonparty. While that case's arbitration was founded under the Labor Management Relation Act, the court's decision analogized the act to the FAA and stated in dicta that "the FAA's provision authorizing an arbitrator to compel the production of documents from third parties for purposes of an arbitration hearing has been held to implicitly include the authority to compel the production of documents for inspection by a party prior to the hearing." *Id.* at 1009. Thus, although the Sixth Circuit failed to rule directly on an arbitrator's nonparty subpoenaing power under the FAA, it appears that the court would agree with the Eighth Circuit's determination that an implicit right to enforce nonparty prehearing subpoenas should be read into the FAA to ensure the efficiency of the arbitration process.

Restricting the Arbitrator's Subpoenaing Power

The Eighth Circuit's view that an implicit right to issue prehearing, nonparty subpoenas exists in the FAA has been rejected by every other appellate court that has directly ruled on the issue. As we have seen, while the Fourth Circuit accepted the possibility of a hardship exception to the prohibition against prehearing, nonparty subpoenas, the court nevertheless rejected the notion that the right to issue such subpoenas was implicit. In a pair of decisions by the Second and Third Circuits, an even more conservative viewpoint was taken, one that found that the FAA not only lacked an implicit right to issue prehearing, nonparty subpoenas but that even a showing of cause could not overcome the statute's plain-language restriction of prehearing, nonparty subpoenas.

In *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404 (3d Cir. 2004), the Third Circuit held that an arbitrator had no power to issue a subpoena to a party's nonparty employee. The court stated that it must rely on the Supreme Court's rules for statutory interpretation, stating that "[t]he Supreme Court has repeatedly explained that recourse to legislative history or underlying legislative intent is unnecessary when a statute's text is clear and does not lead to absurd results." *Id.* at 406 (quoting *U.S. ex rel. Mistick PBT v. Hous. Auth. of City of Pittsburgh*, 186 F.3d 376, 395 (3d Cir. 1999)). Relying strictly on the text of the FAA, the court found that an arbitrator's power is limited strictly to the powers granted by the FAA and that the subpoena must, regardless of the underlying policy behind arbitrations, be rejected.

The Second Circuit's 2008 decision in *Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, 549 F.3d 210 (2d Cir. 2008), similarly rejected anything but a strict reading of the statute and found that prehearing, nonparty subpoenas were prohibited by the FAA. Finding the language of the statute to be plain and unambiguous, the court stated that while there may be valid reasons to allow such

subpoenas, its plain language binds the court and it must rule based on the language—not the underlying policy—of the statute.

It is apparent that no uniform interpretation of the FAA has emerged from the five appellate courts to rule either explicitly or impliedly on the issue. The field becomes even more confused when lower federal court decisions on this matter are examined. Courts sitting in Georgia, Tennessee,

There is a practical solution using the plain language of section 7 of the FAA.

and Louisiana have all ruled in favor of allowing nonparty subpoenas, while courts sitting in Texas and Illinois have ruled that a nonparty can be compelled to produce documents only in accordance with the plain language of the FAA. This landscape is perhaps most confusing for attorneys practicing in Florida's Southern District, in which a pair of court decisions take opposing views as to the permissibility of prehearing document discovery under the FAA. Taken together, the myriad of decisions from both the federal trial and appellate levels can leave parties to arbitration, especially parties arbitrating in jurisdictions that have not directly ruled on the issue, in the dark as to the enforceability of document subpoenas issued to nonparties by arbitrators.

Further Complications

Assuming for the moment that a prehearing, nonparty subpoena was deemed allowable under the FAA,

the question of whether the Federal Rules of Civil Procedure's territorial limitations on subpoenas applies further complicates the matter and calls into question an arbitrator's power to issue discovery orders. The language of the FAA states that subpoenas issued through arbitration must be issued "in the same manner as subpoenas to appear and testify before [federal district] court." 9 U.S.C. § 7. Rule 45 of the Federal Rules of Civil Procedure requires that a subpoena be served "within 100 miles of the place specified [in the subpoena] for the deposition, hearing, trial, production, or inspection." This requirement creates a problem of enforceability because the FAA grants the power to enforce a subpoena issued by the arbitrator only to the court in the district where the arbitrator sits. A plain-language interpretation dictates that if a nonparty is located farther than 100 miles from the arbitration site, the subpoenaing party may have no means of enforcing the subpoena.

Not surprisingly, courts are also split as to whether territorial limitations should be applied to arbitration subpoenas. The Eighth Circuit, which took the most liberal view on an arbitrator's power to issue nonparty subpoenas, likewise takes a liberal view in holding that a court may enforce a document subpoena outside of Rule 45's territorial limitations. *In re Sec. Life Ins. Co. of Am.*, 228 F.3d 865. The Second Circuit, a member of the conservative block of courts to decide this question, took the opposing view, finding that territorial limitations must be read into the FAA's grant of power. *Dynegy Midstream Servs., LP v. Trammochem*, 451 F.3d 89 (2d Cir. 2006). While a split on the issue of the application of territorial limits to an arbitrator's subpoenaing power complicates a determination of how to proceed in arbitration, the question is at least settled in one respect: The debate over territorial limitations seems confined to subpoenas for the production of documents, rather than for the appearance of a witness.

Practical Solutions

Unfortunately, for those practitioners located in a jurisdiction that limits an arbitrator's subpoenaing power, there remains no clear and easy path to obtain nonparty documents before a final hearing. However, there is a practical solution using the plain language of section 7 of the FAA, though it may involve more expense. Assume, for example, that a dispute between the general contractor and the property owner takes place within a jurisdiction that takes a restrictive view on arbitration subpoenas. There is nothing in the plain language of the FAA that would prevent the general contractor from convening the arbitration panel, prior to the final hearing, for the purpose of calling a subcontractor to produce documents. The Second Circuit, in *Stolt-Nielsen SA v. Celanese AG*, 430 F.3d 567, 578 (2d Cir. 2005), explicitly supported this method of circumventing its ban on arbitrators from issuing prehearing, nonparty subpoenas. The court stated that it found that "[n]othing in the language of the FAA limits the point in time in the arbitration process when the subpoena power can be invoked or says that the arbitrators may only invoke this power under section 7 at the time of the trial-like final hearing." Under this approach, the general contractor is able to obtain the requested documents but must incur the not insignificant expense of convening an arbitration panel to do so.

Similarly, if a party is struggling to circumvent the application of Rule 45's territorial subpoenaing power of an arbitrator, it could, for all practical concerns, move the site of arbitration to within 100 miles of the district court where the nonparty is located. There is nothing in the FAA that prohibits an arbitration from relocating for the purposes of document discovery. This solution, however, is also not likely a cheap one. While it has been suggested that a nonparty may waive his or her appearance before the arbitrators and produce the requested documents voluntarily, the inconvenience of circumventing the

FAA's plain language puts a real kink in the efficiency of an arbitration proceeding when less-than-cooperative nonparties are involved.

Conclusion

Arbitration is the favored means of dispute resolution for the construction industry for good reason. Arbitration allows parties to bargain for and control numerous aspects of the proceedings that would be left

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up to chance in traditional litigation. As we have seen, however, when documents are sought from nonparties to the arbitration agreement, the ability of the arbitrator to compel production of relevant materials is questionable. In many jurisdictions, there is simply no way to enforce a subpoena on a nonparty—especially if that nonparty is located outside the federal district overseeing the arbitration—without enduring added expense and time, two qualities of litigation all parties who submit to arbitration wish to avoid. The circuits are sufficiently split on the issues discussed in this article, and it is time for a higher power, either the Congress or the Supreme Court, to step in and resolve the issue.

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Modified Total Cost Claims

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first necessary to put the total cost claim into context—in terms of both pros and cons.

How Total Cost Claims Morph into MTC Claims

The courts' most favored method for a contractor to prove an equitable adjustment claim is proof of actual reasonable costs incurred as a result of the adverse impact. However, a calculation of the direct economic impact is not always possible in complex projects in which each change or delay and its related causal relationship to actual construction costs cannot be isolated.

When a calculation of actual costs is not possible, courts have used a total cost approach to determine the contractor's amount of damages. A total cost claim takes a contractor's total costs, subtracts its bid amount and, in its purest form, embraces an assumption as to causation of the additional costs—namely, that they are due to the acts or omissions of the owner or its architect. However, the total cost approach is disfavored by courts because it assumes, without an evidentiary foundation, that the contractor's bid was accurate (i.e., there was no underbid) and that the costs incurred were reasonable (i.e., no inefficiency on the part of the contractor or its subcontractors). Given the lack of precision inherent in a total cost claim, it is used only as a last resort when no other approach is available or when the breach or unexpected conditions pervade substantial areas of performance. In an attempt to work around these shortcomings, some courts have required the jury to make specific findings