July 13, 2005

To the SEC

Re: SR-NASD-2005-079 (proposed subpoena rule for NASD arbitrations)

Please accept this submission as my comment on the NASD's proposed subpoena rule.

I am a member of Deutsch & Lipner, attorneys who have for many years represented investors in SRO arbitration. I am also Prof. of Law at the Zicklin School of Business at Baruch College, CUNY. I have served on the NASD's NAMC, and am a past-President and current Board Member of PIABA.

I suppport the proposal. The NASD and NYSE rules currently have no provisions governing third-party discovery. A rule is desperately needed, because securities industry lawyers are frequent abusers in this area.

It is black-letter law that third-party discovery is disfavored in arbitration (see cases and cites, infra). Yet securities industry defense attorney routinely ignore (and mis-cite the law). These attorneys sign "subpoenas" as though they are authorized by law, and they use these subpoenas to fish and harrass, seeking documents from, inter alia, brokerages banks, employers, accountants and other extraneous third parties. These attorneys have no regard for investor privacy, and they frequently craft overbroad subpoenas seeking ridiculous documents. These attornewys then serve these "phony" subpoenas without arbitral permission, and without advance notice to other parties. As the next section of this comment shows, that is wrong and illegal.

THE LAW

Section 7 of the Federal Arbitration Act ("F.A.A.") authorizes arbitrators to issue subpoenas. It provides: "[T]he arbitrators selected . . . or a majority of them, may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case.
The fees for such attendance shall be the same as the fees of witnesses before masters of the United States courts. Said summons shall issue in the name of the arbitrator or arbitrators, or a majority of them, and shall be signed by the arbitrators, or a majority of them, and shall be directed to the said person and shall be served in the same manner as subpoenas to appear and testify before the court; if any person or persons so summoned to testify shall refuse or neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators, or a majority of them, are sitting may compel the attendance of such person or persons before said arbitrator or arbitrators, or punish said person or persons for contempt in the same manner provided by law for securing the attendance of witnesses or their punishment for neglect or refusal to attend in the courts of the United States."

As will be seen, nothing in the F.A.A., however, authorizes attorneys to issue subpoenas in arbitration.

The (state) Uniform Arbitration Act ("U.A.A."), like the F.A.A., authorizes only the arbitrators to issue subpoenas. In states which have enacted the U.A.A., attorneys have no statutory power to issue any sort of subpoena in arbitration, whether it be for attendance or documents, whether for hearing or pre-hearing discovery. That is not to say that attorneys don't issue and sign such documents (it happens). And it is not to say that addressees of such "subpoenas" don't comply (they often do). But such an attorney-issued "subpoena" in a U.A.A. state misrepresents itself as placing the addressee "under penalty" for non-compliance.

In 2000, the National Conference of Commissioners on Uniform State Laws revised the Uniform Arbitration Act (hereinafter referred to as the R.U.A.A.). Section 17 addresses subpoenas. Like its predecssor the U.A.A., the R.U.A.A. authorizes "an arbitrator" to issue subpoenas, but nowhere does it empower attorneys to do so. And Section 17(d) makes clear that that grant of authority to the arbitrators (and not the lawyer) extends to compelling discovery (both testimonial and documentary) from third parties. The R.U.A.A. is clear - only the arbitrators may subpoena. The R.U.A.A. has been adopted in a couple of states.

Importantly, neither the Federal Arbitration Act nor the Uniform Arbitration Act (or the R.U.A.A.) thus empower attorneys in an arbitration to issue subpoenas. In National Broadcasting Co. v. Bear Stearns, the Second Circuit Court of Appeals explained that section 7 of the F.A.A. "explicitly confers authority only upon the arbitrators, by necessary implication, the parties to an arbitration may not employ this provision to subpoena documents or witnesses." (Italics in original). Again, only the arbitrators can subpoena, but the lawyers do it anyway.

A few federal appellate courts have considered the issue of the even the arbitrator's right to compel third-party discovery of documents by arbitrator-signed subpoena. Those cases, of course, deal only with the arbitrators power to issue third-party discovery subpoenas; none of them authorize attorneys to issue discovery subpoenas on their own.

In Comsat v. National Science Foundation, the 4th Circuit read §7 of the F.A.A. even more narrowly. The court held that the "attend before them" language of the statute made ultra vires any pre-hearing arbitration subpoenas to third parties whatsoever. The court wrote that parties to an arbitration necessarily forego certain procedural rights, and such parties cannot "reasonably expect to obtain full-blown discovery from the other or from third parties."

The Third Circuit recently agreed in Hay Group, Inc. v. E.B.S. Acquisition Corp.. In that case, the court stated that the text of F.A.A. section was "straightforward", and that it prohibited third-party discovery in arbitration. Rejecting arguments of efficiency, the

court ruled that the statute permits document production only "at a hearing before the arbitrators". The court explained that the rule had benefits - namely "discourag[ing] the issuance of large-scale subpoenas upon non-parties." The court felt that the F.A.A.'s restriction on third-party discovery in arbitration was beneficial, because it forced a party seeking a subpoena:

To consider whether the documents are important enough to justify the time, money and effort the subpoenaing parties will be required to expend if an arbitrator is needed. Under a system of pre-hearing document production, by contrast, there is less incentive to limit the scope of discovery and more incentive to engage in fishing expeditions that undermine some of the advantages of the supposedly shorter and cheaper system of arbitration.\

* * *

New York law, upon which the firms sometimes rely, is the same as federal law regarding the unavailability of third-party discovery in arbitration.
The New York Court Appeals said in De Sapio v. Kohlmeyer: "The availability of disclosure devices is a significant differentiating factor between judicial and arbitral proceedings. "It is contemplated that disclosure devices will be sparingly used in arbitration proceedings. If the parties wish the procedures available for their protection in a court of law, they ought not to provide for the arbitration of the dispute." (8 Weinstein-Korn-Miller, N.Y.Civ.Prac., para 7505.06, pp. 75-101). Under the CPLR, arbiters do not have the power to direct the parties to engage in disclosure proceedings."

The Court of Appeals has also held in Matter of Terry D.:"Generally, a subpoena duces tecum may not be used for the purpose of discovery or to ascertain the existence of evidence. [citation omitted]"

The Appellate Division, First Department, has stated unequivocally,
that: "The panel did, however, exceed its authority by directing pre-arbitration disclosure. "Under the CPLR, arbiters do not have the power to direct the parties to engage in disclosure proceedings." The Appellate Division Second Department has ruled: [I]t is firmly established that "under the CPLR, arbiters do not have the power to direct the parties to engage in disclosure proceedings." [citations provided on request.]

These courts are not the only authorities lined up against third-party discovery in arbitration. In addition to Weinstein-Korn-Miller (cited in De Sapio, above), Prof. David Siegel, the unquestioned authority on New York procedural law, explains in his Practice Commentary to CPLR 2302 (the statute
upon which our adversaries rely): "The Advisory Committee further notes that
this provision is not intended to authorize the use of the disclosure devices (now in Article 31 of the CPLR) by any nonjudicial body; that [this section] confers the subpoena power only for the hearing before such body and not, by implication, for the steps prepatory to the hearing. See 1st Rep Leg. Doc (1957), at p.162" See D. Siegel, Practice Commentaries, C2302:1, McKinney's, p.248.

Vincent Alexander is in accord in his commentary to CPLR 7505: "The subpoena power conferred by CPLR 7505 is limited to the procuring of evidence for the hearing or trial of the dispute. Depositions and other forms of pretrial disclosure are ordinarily not contemplated in arbitration proceedings."
See V. Alexander, Practices Commentaries, CPLR 7505, McKinney's, at p.682.

* * *

The law is thus crystal clear – attorneys do not have the power to issue discovery subpoenas in arbitration. No other conclusion can possibly be drawn. Even arbitrators may lack that power.

None of this is meant to suggest or assert that attorneys lack the power to issue subpoenas to compel attendance "at a hearing before the arbitrators."
But a subpoena returnable in a lawyer's office is certainly invalid, regardless who signed it.

THE CURRENT PROPOSAL

The current proposal, unfortunately, does not stamp out the practice, as it should. But at least the practice is to be regulated and made orderly, giving the investor a chance to object BEFORE the intimidating, illegal subpoena is served. That is a dramatic improvement.

Although I support the tenor of the rule, part (e) of the rule is unnecessary, and leaves in the chance for game-playing and harassment. Rulings on subpoenas can come fast enough, and the subjects of these subpoenas (particularly banks and brokerages) are document retainers anyway.

Finally, part (g) seems to remove the option of going to court to quash an illegal subpoena. The Rule should thus read: "arbitratrators and any court of competent jurisdiction shall have power to quash any improper subpoena"

Thank you for the opportunity to comment

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