
Do Arbitrators Have Power to Exclude Relevant Evidence?

Abraham J. Gafni

ADR

Several articles in this ADR series in *The Legal* have pointed out that in agreeing to arbitration, counsel must consider whether the hearing is to be conducted pursuant to rules of evidence. Often ignored, however, is the extent to which the arbitrator will be constrained by such rules.



Differing views on this issue were recently reflected in a decision of the U.S. Court of Appeals for the Second Circuit vacating an order of the district court that had itself vacated an award by the arbitrator on evidentiary grounds, *LJL 33rd Street Associates LLC v. Pitcairn Properties*, No. 11–5425–cv, decided July 31.

The controversy in that case arose out of LJL's exercise of its contractual option to purchase Pitcairn's ownership stake in a residential building in New York City.

The agreement between the parties provided that if Pitcairn and LJL were unable to agree upon the stated value (i.e., the fair market value) of the property, either party might elect determination by the expedited arbitration procedures of the American Arbitration Association (AAA) with certain modifications, including that each party "shall be entitled to present evidence and witnesses to support its position and to cross-examine witnesses presented by the other."

As the parties could not agree on the stated value, they appointed an arbitrator who, pursuant to the agreement, appointed an appraiser to determine the property's value. At the arbitration hearing, each party introduced reports and testimony of appraisers who were subject to cross-examination.

During the arbitration, however, Pitcairn also sought to introduce four other exhibits that stated conclusions as to the value of the property. These included: (1) an asset summary report by one company, (2) a valuation by a second company based on materials earlier presented to Pitcairn's board of directors, (3) a valuation by an individual of an investment management company with ties to Pitcairn, and (4) an unrelated company's nonbinding offer to purchase the property for a specific price.

LJL objected to the introduction of these documents on hearsay and other grounds.

The arbitrator sustained the objections to the four exhibits, stating only that they "shall not be admitted into evidence and shall not be considered by the arbitrator or the neutral appraisal expert."

After the arbitrator produced his determination of stated value, cross-petitions to vacate were filed in the district court, including one by Pitcairn contending that the arbitrator wrongfully excluded the four exhibits in violation of the Federal Arbitration Act (FAA).

The section of the FAA upon which Pitcairn was relying provides that a reviewing court may vacate an arbitration award "where the arbitrators were guilty of misconduct in ... refusing to hear evidence pertinent and material to the controversy." In applying this section, the district court held that excluding the four exhibits denied Pitcairn "a

meaningful opportunity to present pertinent and material evidence of the value of the property, which rendered the proceeding 'fundamentally unfair.'" It determined that this was "misconduct warranting the vacating of the award." The district court stated that "this exclusion 'prevented Pitcairn from effectively demonstrating' the agreement of four experts that the property was worth substantially more than LJJ's valuation."

While recognizing that the excluded valuation documents were all hearsay, the district court emphasized that the arbitrator was under no obligation to comply with strict evidentiary rules; and, most pointedly, that the rules of the AAA themselves, which controlled this arbitration, stated that "conformity to legal rules of evidence shall not be necessary."

Based on its analysis of the nature of this arbitration, the district court concluded that the four exhibits should not have been excluded on the ground that they were hearsay documents; rather, they should have been admitted, and their status as hearsay should have been considered not as to their admissibility but only to the weight accorded them.

The court of appeals disagreed with the conclusions of the district court. It acknowledged that arbitrators under the rules of the AAA are not bound by the rules of evidence and may consider hearsay; however, they are not obliged to admit all relevant hearsay evidence. This is particularly true "(a) when the evidence could be presented without reliance on hearsay and (b) its hearsay nature is unfairly prejudicial to the adversary."

The appellate court found that both of these factors were present.

First, there was no good reason for Pitcairn to rely on the hearsay contained in the four exhibits, as it could have presented the evidence merely by calling the "makers of the exhibits"; they would then have been subject to LJJ's cross-examination, which would have been directed at undermining the probative value of the exhibits.

The court found that the need for such cross-examination was particularly critical here "where the expert valuations ... are the product of so many complex factors and so many assumptions."

Second, to allow these hearsay exhibits to be presented to the appointed independent appraiser without LJJ having had the opportunity to test their conclusions and underlying reasoning through cross-examination would have been severely prejudicial to LJJ. While recognizing that Pitcairn would also be prejudiced by the exclusion of the exhibits, the court emphasized that there was no showing that Pitcairn could not overcome this prejudice by calling the four individuals whose valuations were contained within the four hearsay exhibits.

It would appear, however, that had Pitcairn demonstrated that it lacked the ability to call the individuals who made the hearsay statements, the appeals court might have been more inclined to conclude that the arbitrator should have been obliged to accept the hearsay documents.

The appeals court, therefore, disagreed with the finding of the district court that the arbitrator's exclusion of Pitcairn's exhibits constituted "misconduct" as discussed in the FAA. Rather, it recognized that arbitrators have substantial discretion in admitting or excluding evidence, and a finding that the evidentiary rulings of the arbitrator impaired "fundamental fairness" is not so easily demonstrated.

The lesson to be learned seems clear. Parties and counsel often assume that if the rules of the ADR provider state that the rules of evidence will not apply (such as the rules of the AAA), virtually all hearsay will be admissible so long as it is relevant; and, its hearsay status will only go to the weight to be assigned to it by the arbitrator.

As this case demonstrates, however, merely because an arbitrator has the power to consider hearsay evidence does not mean that he or she will necessarily allow its admission. The arbitrator may decide that it is cumulative, that its relevance is only tangential, or, as in this case, that it is highly prejudicial and its proponent had available other means of submitting it.

Counsel, therefore, should be particularly careful in reviewing with an adversary the ground rules with respect to the introduction and use of hearsay exhibits, including, in particular, expert reports. Unless there is agreement as to the

admissibility of the report, counsel would be well advised to request a prehearing ruling from the arbitrator. Should the arbitrator decide that the hearsay exhibit will not be admissible for any reason such as undue prejudice, counsel will have the opportunity to devise an alternative approach, including, perhaps, as suggested by the appellate court in the *LJL* case, bringing in the expert witnesses so that his or her testimony may be tested through cross-examination.

Abraham J. Gafni *is a mediator/arbitrator with ADR Options and a professor at Villanova University School of Law.*