

CSP Technologies, Inc. v Hekal

2007 NY Slip Op 34200(U)

December 14, 2007

Supreme Court, New York County

Docket Number: 0117053/2006

Judge: Sheila Abdus-Salaam

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SUPREME COURT OF THE STATE OF NEW YORK – NEW YORK COUNTY

PRESENT: HON. SHEILA ABDUS-SALAAM
Justice

PART 13

CSP Technologies, Inc. and CV Holdings, LLC.

INDEX NO. 117053/06

MOTION DATE 10/4/07

- v -

MOTION SEQ. NO. 002

Ihab M. Hekal

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motlon/ Order to Show Cause – Affidavits – Exhibits ...

Answering Affidavits – Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this application by petitioners is granted and the revised¹ cross-motion by respondent, is granted as indicated below.

Petitioner seeks to vacate an order of the arbitration panel issued in August 2007 which denied an application by CSP to preclude prehearing discovery in the arbitration. Respondent has cross-moved for an order directing petitioner to comply with his discovery demand.

UNFILED JUDGMENT

This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).

¹Respondents served a revised notice of cross-motion dated September 24, 2007 for an order directing petitioners to produce all documents requested in the document demand that had been revised on September 6, 2007 or otherwise direct petitioners to produce all documents requested in the July 24, 2007 subpoenas.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Hekal, the claimant in the arbitration² and respondent in this proceeding, had sought documents from CSP pertaining to CSP's dealings with certain companies, including correspondence, documents showing income earned and sale of products, and other agreements between CSP and those companies. Hekal claims that in order to present a proper case and to determine what is owed to him, he must have access to these records. He requested that those documents be produced prior to the arbitration hearing. CSP moved to preclude discovery on the ground that under New York arbitration law, the arbitrators lack the power to order the parties to engage in any form of discovery prior to the hearing.

The arbitrators denied CSP's motion, concluding that the issue of prehearing discovery is not an issue of substantive law, but " . . . strictly an issue of procedure in the course of a pending arbitration – a matter that is left to the arbitrators. *See, e.g. Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 123 S.Ct. 588, 592 (2002)* (even procedural questions which grow out of the dispute and bear on its final disposition are "presumptively *not* for the judge, but for an arbitrator, to decide" (emphasis in original))." (Decision, p. 3.) The arbitrators held that the proceeding is governed by the rules of the AAA, which provide that the arbitrator may direct the production of documents. The panel rejected CSP's argument that under New York arbitration law, arbitrators lack the power to order the parties to engage in disclosure proceedings. The panel wrote:

. . . [E]ven if the Panel were compelled to delve into the cases (most of them decided over twenty years ago) that speak of restrictive discovery in an arbitration, the conclusion would be that modern New York arbitration law and practice has for many

²The substance of the dispute between Hekal and CSP is set forth in this court's prior order dated January 30, 2007 which granted a petition to stay arbitration of Hekal's claim for punitive damages.

years recognized the power of arbitrators to decide procedural issues, including the efficacy of a prehearing document exchange. Indeed, "New York Arbitration Law" in the form of CPLR Section 7505 would permit the issuance of subpoena duces tecum to compel the production of the very same documents that, for reasons of efficiency, the panel has ordered produced at this point in the proceeding." (In a footnote, the panel wrote that the claimant had also directed a subpoena to respondents seeking the documents).

[Decision, p. 4]

In my previous decision, I determined that this arbitration is governed by New York law. While the Panel was not persuaded to "delve" into the cases cited by CSP in support of its motion to preclude prehearing disclosure, this court has reviewed those cases and concluded that prehearing disclosure cannot be ordered by arbitrators in an arbitration governed by New York Law and the CPLR. The Panel concluded that CSP's reliance on De Sapio v. Kohlmeyer (35 NY2d 402 [1974]) was "misplaced" and that "*Kohlmeyer* does not stand for the proposition that New York arbitration law precludes discovery in an arbitration." (Decision, p. 4.)

I disagree. The Court of Appeals expressly stated in De Sapio that "[u]nder the CPLR, arbiters do not have the power to direct the parties to engage in disclosure proceedings. (Par. 7506.06) While a court may order disclosure "to aid in arbitration" pursuant to CPLR 3102 (subd. [c]), it is a measure of the different place occupied by discovery in arbitration that courts will not order disclosure "except under extraordinary circumstances". (citation omitted.)" (De Sapio, at 406.) Eleven years after De Sapio was issued, the Court of Appeals held that "[p]arties electing the benefits of arbitration, including the freedom from disclosure in accordance with the CPLR . . . cannot also draw on the judicial process for a particular advantage, such as pretrial disclosure not generally available in

arbitration." (Sherrill v. Grayco Builders, Inc., 64 NY2d 261, 273-274 [1985].)

The Panel seemed persuaded by the fact that most of the cases cited by CSP were decided over twenty years ago, and it indicated that ". . . modern New York arbitration law and practice has for many years recognized the power of arbitrators to decide procedural issues, including the efficacy of a prehearing document exchange." (Decision, p. 4.) However, De Sapio and Grayco reflect the current, "modern" state of the law in New York as indicated by the First Department's citation to those cases earlier this year in Accessory Corporation v. Capco Wai Shing, 39 AD3d 344 [2007]). The Panel's reliance on In re Application of Technostroyexport (853 F. Supp. 695 [S.D.N.Y. 1994] to express the modern view is misguided because that decision did not involve the application of New York arbitration law.

The Panel's conclusion that Hekal can engage in prehearing disclosure if ordered by the arbitrators was premised upon the fact that the rules of the AAA provide that the arbitrator may direct the production of documents and other information. But the application of the AAA rules cannot trump the application of New York law in this arbitration. I have previously concluded that the AAA rules, which are broad enough to permit an award of punitive damages, cannot override the provision in the arbitration agreement that the claim shall be submitted to the AAA pursuant to New York arbitration Law, and that accordingly, arbitration of a punitive damages claim is precluded (see January 30, 2007 decision, p. 4). Similarly, prehearing disclosure ordered by *the arbitrators*, although included in the rules of the AAA, is precluded through the application of New York law to this arbitration.

However, *the court* may order discovery in aid of arbitration (CPLR 3102 (c)) where there has been a demonstration of extraordinary circumstances (De Sapio at 406). "The test is necessity rather than

convenience (citations omitted)." (State Farm Mutual Automobile Insurance Company v. Wernick, 90 AD2d 519 [1982]). Hekal has shown that he needs document discovery, including books and records of CSP, in order to prove his claim that he is owed royalties pursuant to the consultancy agreement. Here, as in Hendler & Murray, P.C. v. Lambert (127 AD2d 820 [1987] and Application of Mooock (99 AD2d 1003 [1984]), both of which involved the arbitration of a claim requiring the valuation of a partnership, the claimant needs access to books and records "in order to present a proper case to the arbitrator[s]." (Mooock, Id at 1004.) This type of discovery, which is sought in connection with an accounting and a valuation, is different from the discovery sought by the claimant in Spiegel v. D.H. Blair & Co., (289 AD2d 22 [2001], app denied 97 NY2d 612 [2002]), a case cited by CSP. In Spiegel, the First Department held that " . . . petitioner's wish to ascertain whether respondents would be able to satisfy an arbitration award does not amount to any extraordinary circumstance warranting discovery under [CPLR 3102 (c)] (*see, De Sapio v. Kohlmeyer*, 35 NY2d 402)." (id. at 23.) Hekal does not seek discovery in order to learn whether CSP could satisfy an award, he needs discovery in order to prove his claim.

As for CSP's argument that there can be no extraordinary circumstances here because Hekal has not made any request for an audit of CSP's books and records pursuant to his right under the consultancy agreement since 2002, Hekal argues that he did make an audit request and that it was denied by CSP. But whether such a request was made, and if not, whether it should have been made prior to filing this arbitration claim, is not germane because the issue here is whether Hekal can prove his claim in this arbitration without discovery. The Panel concluded that he cannot, and this court agrees, as did the court in Mooock which involved the valuation of a partnership. The claimant there must have had the right to inspect the books and records of the partnership before he filed a demand for arbitration

and nevertheless he was granted prehearing discovery of the books and records.

In sum, while this court concurs with the Panel's assessment that discovery is necessary in this arbitration, the court is constrained to vacate the Panel's decision on the ground that arbitrators cannot order discovery in an arbitration governed by New York arbitration law. Yet, the arbitrators, to whom the claim will be presented, are in the best position to determine what type of discovery is required. Thus, this court will order prehearing discovery which shall be supervised by the arbitrators. They ordered that Hekal's first demand be stricken and they directed him to serve a narrower, more detailed demand. Hekal subsequently served a demand dated September 6, 2007 and CSP has argued to this court that the revised demand is also overly broad and burdensome. In its decision, the Panel provided for a mechanism by which CSP could file objections to the revised demands served by Hekal and that mechanism can be employed at this point or the Panel can set new parameters as it deems appropriate.

Thus, Hekal's cross-motion is granted to the extent of directing CSP to respond to the demands dated September 6, 2007 within 30 days of service of a copy of this order with notice of entry. The parties should seek guidance from the Panel as to how objections to the demands should be raised.

This constitutes the judgment of the court.

Dated: 12/14/07

UNFILED JUDGMENT
This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

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