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Non-signatories in International Arbitration: An American Perspective

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I. INTRODUCTION

Professor Hanotiau's thoughtful analysis of the swirl of cases relating to the involvement of non-signatories in arbitration proceedings focuses, properly, on consent as the essential element for determining when a person or entity that has not actually signed an agreement to arbitrate should be permitted to take advantage of such an agreement or, more rarely, compelled to comply with one.[1] Consent is also central to the American approach to this issue, although the complexity of the American approach has sometimes caused us to lose sight of its importance.

As Professor Hanotiau notes, the United States has made a disproportional contribution to the case law on this subject. There is an explanation for the volume of American case law, however, and understanding the explanation is central to putting the American cases in perspective. The explanation, in its simplest form, is that the American litigation system has a number of features that cause many parties to prefer to avoid it. Since an equal and opposite number prefer litigation in American courts to any system of alternative dispute resolution, the two views frequently clash.[2] The litany of the features that make American litigation a magnet to some and frightening to others will be familiar to practitioners of international arbitration: the trial of civil cases by juries, wide-ranging and intrusive discovery, the availability of contingent fees to encourage lawyers to bring cases, the availability of class actions to combine many small claims into one huge claim, and the ability to claim punitive damages (even if such damages are infrequently recovered).

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1. Bernard HANOTIAU, "Non-Signatories in International Arbitration: Lessons from Thirty Years of Case Law", this volume, pp. 341-358.

2. Lord Denning's famous observation that "As a moth is drawn to the light, so is a litigant drawn to the United States," *Smith Kline & French Labs Ltd. v. Bloch* [1983] 1 WLR 730, was not made about American arbitration.

Many American companies are as fearful of these features as most foreign companies are, and this fear has contributed a good deal to the popularity of arbitration in the United States. One effect of this reaction, however, is that many American companies have attempted to use arbitration as a sort of talisman to ward off the most feared features of American litigation, especially in form contracts with their customers and employees. There is currently pending before our Supreme Court, for example, a petition for a writ of *certiorari* to review a decision of the Supreme Court of California holding that it is unconscionable to include in an arbitration agreement with consumers a waiver of the right to bring a class action.[3] This type of dispute, especially in the fields of consumer and employment litigation, is behind many of our reported cases, because our Supreme Court has held that the question of *who* may be bound to arbitrate is a decision to be made by the courts, not the arbitrators.[4]

II. BASES FOR REFERRAL TO ARBITRATION USED BY US COURTS: THREE CASES

1. *InterGen v. Grina*

It may be useful to use an actual case to illustrate how these forces can work in an international setting. The case of *InterGen N.V. v. Grina*, decided by the First Circuit Court of Appeals in 2003,[5] involved a dispute about the performance of a power plant built in England for a subsidiary of InterGen by a subsidiary of ALSTOM, pursuant to contracts between the subsidiaries that contained LCIA arbitration clauses. When negotiation to resolve the dispute broke down, the InterGen parent company sued several of the upstream ALSTOM holding companies (and one of their Massachusetts employees) in Massachusetts state court, alleging that "a pattern of false and deceptive statements" had induced InterGen to select ALSTOM equipment for the plant.[6] InterGen's reasons for wanting to assert its claims in an American court, rather than in an arbitration, are evident from the relief it sought: multiple damages under the Massachusetts Unfair Trade Practices Act, which permits a court to double or treble the actual damages awarded by a jury.[7]

ALSTOM removed the case to federal court, under a statute that provides for federal jurisdiction of cases related to an arbitration agreement "falling under the [New York] Convention",[8] and sought an order compelling arbitration of the dispute. InterGen objected that none of the parties on either side of the lawsuit – neither the plaintiff

3. *Parrish v. Cingular Wireless, LLC*, A105518, 2005 Cal. App. Unpub. LEXIS 9021 (Cal. Ct. App. 3 Oct. 2005), pet. for cert. pending sub nom. *Cingular Wireless LLC v. Mendoza*, No. 05-1119 (filed 3 Mar. 2006).
4. *First Options of Chicago v. Kaplan*, 115 S. Ct. 1920 (1995).
5. *InterGen N.V. v. Grina*, 344 F.3d 134 (1st Cir. 2003).
6. Complaint and Jury Demand, *InterGen N.V. v. Grina et al.*, No. A01-905 (Bristol County Super. Ct. 20 July 2001).
7. M.G.L.A. 93A Sect. 9.
8. 9 U.S.C. Sect. 205; *see* 344 F.3d at 140.

parent company nor the defendant holding companies – was a signatory to any of the project contracts that contained the agreements to arbitrate.[9] ALSTOM attempted to persuade the court that it was appropriate to compel the non-signatory plaintiff to arbitrate under almost every one of the theories recognized by American courts as a basis for ordering arbitration by or with non-signatories. Specifically, ALSTOM argued:

– That InterGen was bound by the arbitration agreement because it had pleaded that it stood in the shoes of the contracting subsidiary, so that it could be considered its successor or alter ego;[10]
– That InterGen should be required to arbitrate because it had asserted rights as a third party beneficiary of the contracts containing the arbitration clauses;[11]
– That InterGen should be estopped from denying its obligation to arbitrate, because the claims asserted were founded in and intertwined with the contracts containing the arbitration clauses;[12]
– That InterGen should be required to arbitrate, because the contracts containing the arbitration clauses were signed by its agent.[13]

ALSTOM also argued that InterGen's pleadings treated all the ALSTOM entities as a single whole, so that each of the ALSTOM entities should be entitled to claim the benefits of the agreements to arbitrate signed by the ALSTOM project subsidiaries.[14]

The District Court denied the motion to compel arbitration, because (in a sentence of which Professor Hanotiau would approve) "not all of the persons and entities" sought to be compelled "have manifested consent" to arbitration at the LCIA.[15] The First Circuit ultimately affirmed that order, although for different reasons than those articulated by the District Court.[16] In sending the case back to the District Court, the First Circuit

9. 344 F.3d at 140.
10. *Ibid*. at 148.
11. *Ibid*. at 146.
12. *Ibid*. at 145.
13. *Ibid*. at 147.
14. *Ibid*. at 145. The First Circuit never addressed whether ALSTOM could compel arbitration, because it found that InterGen was not obligated to arbitrate.
15. *InterGen N.V. v. Grina*, 2002 WL 32067127 (D. Mass. 6 Nov. 2002).
16. The District Court's opinion contained some notable reasoning:

> "[U]nder the Constitution of the United States, I have no authority to compel proceedings in London. The Convention [on the Recognition and Enforcement of Foreign Arbitral Awards] cannot grant me that authority.
> (....)
> This court has available to it no means of enforcement of the kind of order defendants propose. For example, it is beyond genuine dispute that this court is without authority to order the United States Marshal for the District of Massachusetts to send a team of deputies to London to find and effect service on all interested persons and entities.
> (....)
> The record before me does not include any evidence that the London Court [of International Arbitration] is a private entity. Indeed, the record supports an inference that the London Court

recognized all the legal theories advanced by ALSTOM as valid bases for requiring arbitration of a dispute involving a non-signatory to an arbitration agreement: Judicial estoppel, equitable estoppel, third-party beneficiary, agency, and alter ego.[17] But, the court reasoned,

> "courts should be extremely cautious about forcing arbitration in 'situations in which the identity of the parties who have agreed to arbitrate is unclear'.... [N]o party to this case, plaintiff or defendant, is a signatory to any of the five agreements. Thus, if ALSTOM is to invoke any of the designated arbitration clauses against InterGen, it must somehow go beyond the four corners of the agreements themselves and show both that it is entitled to the agreements' benefits and that InterGen is obliged to shoulder their burdens."[18]

The court concluded that none of the arguments advanced by ALSTOM, all of which it recognized as valid legal theories, achieved that objective on the particular facts before it.[19]

2. International Paper

While I disagree with the *InterGen* court's conclusion (having represented the losing party), the *InterGen* opinion does represent a trend by American courts that should be reassuring to many. During the decade from roughly 1990 to 2000, American courts developed – one might even say invented – a number of solutions to the problems presented when one party to a commercial relationship seeks to avoid an arbitration clause to obtain a perceived advantage from resorting to the court system, or (more rarely) when another party seeks to take advantage of an arbitration agreement to which it is not a party.[20] The courts did so applying what the Fourth Circuit described as "well-established common law principles [which] dictate that in an appropriate case a nonsignatory can enforce, or be bound by, an arbitration provision within a contract executed by other parties".[21] Four of these theories – agency, incorporation by reference, third party beneficiary, and assumption by conduct – were relatively

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is a governmental entity. Thus it could not be free to proceed independently, as the AAA does."

Ibid. at *2.

17. 344 F.3d at 144-150.
18. 344 F.3d at 143, quoting *McCarthy v. Azure*, 22 F3d 351, 355 (1st Cir. 1994).
19. *Ibid.* at 150.
20. E.g., *McBro Planning & Dev. Co. v. Triangle Elec. Constr. Co.*, 741 F.2d 342 (11th Cir. 1984); *J.J. Ryan & Sons, Inc. v. Rhone-Poulenc Textile, S.A.* 863 F.2d 315 (Cir. 1988); *Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110 (3rd Cir. 1993); *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753 (11th Cir. 1993); *Thomson-CSF, S.A. v. American Arbitration Association*, 64 F.3d 773 (2nd Cir. 1995); *Bel-Ray Co. v. Chemrite (PTY) Ltd.*, 181 F.3d 435 (3rd Cir. 1999); *Smith/Enron Cogeneration Ltd. v. Smith Cogeneration Int'l, Inc.*, 198 F.3d 88 (2d Cir.1999); *Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen, GmbH*, 206 F.3d 411 (4th Cir. 2000).
21. *Int'l Paper Co.*, 206 F.3d at 416-417.

uncontroversial, if occasionally difficult to apply. Two others – alter ego and equitable estoppel – caused a good deal more trouble, because of the element of misconduct or sharp practice that is explicit in the first theory and that tends to be applied in practice in the second.[22]

The doctrine of equitable estoppel, especially, has given rise to considerable confusion, and to a corresponding amount of anxiety. It was explained by the Fourth Circuit as follows:

> "Equitable estoppel precludes a party from asserting rights 'he otherwise would have had against another' when his own conduct renders assertion of those rights contrary to equity. In the arbitration context, the doctrine recognizes that a party may be estopped from asserting that the lack of his signature on a written contract precludes enforcement of the contract's arbitration clause when he has consistently maintained that other provisions of the same contract should be enforced to benefit him."[23]

The decision of the Fourth Circuit in *International Paper,* from which this passage is quoted, is probably the high water mark of the willingness of American courts to require non-parties to arbitrate. That case involved the purchase by an American company of a piece of equipment made in Germany, and sold by the German company to a distributor under a contract that contained both warranties and an arbitration clause, and resold by the distributor to an American purchaser. By the time the purchaser (which was not a signatory to the contract) realized that the equipment didn't work, the distributor was bankrupt, so the purchaser sued the manufacturer in an American court for breach of the warranty. The Court of Appeals held that, when the purchaser invoked the warranties, it estopped itself from refusing to arbitrate under the arbitration agreement in the same contract.[24] The case was therefore ordered to arbitration.

Since about 2000, when *International Paper* was decided, our courts have become increasingly cautious about requiring non-signatories to arbitrate, as illustrated by the *InterGen* decision. This appears to have occurred even in commercial settings where there was no question about a consumer or an employee needing special protection. This caution was most clearly expressed by our Second Circuit Court of Appeals, in a case in which an investor (a foreign company) commenced an arbitration against both its broker, with whom it had a contract containing an arbitration clause, and the manager of the investment fund that had performed badly.[25] The fund manager was an affiliate of the broker's, but was not a signatory to any contract containing an agreement to arbitrate. The Second Circuit held that the fund manager was not obligated to arbitrate the investor's claim.[26] The court explained:

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22. *See ARW Exploration Corp. v. Aguirre,* 45 F.3d 1455, 1460-1461 (10th Cir. 1995).

23. *Int'l Paper Co.,* 206 F.3d at 417-418.

24. *Ibid.* at 418.

25. *Merrill Lynch Investment Managers v. Optibase, Ltd.,* 337 F.3d 125 (2d Cir. 2003).

26. *Ibid.* at 131-132.

> "[I]t matters whether the party resisting arbitration is a signatory or not. '[A] court should be wary of imposing a contractual duty to arbitrate on a non-contracting party.' Thus, a willing non-signatory seeking to arbitrate with a signatory that is unwilling may do so under what has been called an 'alternative estoppel theory,' which takes into account 'the relationships of persons, wrongs, and issues.' But a willing signatory (such as [the investor]) seeking to arbitrate with a non-signatory that is unwilling (such as [the fund manager]) must establish at least one of the five theories described in Thomson-CSF."[27]

Although non-Americans may not recognize all the "five theories" referred to as adequate bases for arbitration, they will certainly recognize the Second Circuit's statement as a manifestation of concern for the kind of consent that Professor Hanotiau would like the courts to focus on.[28]

3. *Comer v. Micor, Inc.*

The Ninth Circuit, in a very recent decision, made the same distinction between whether the party to be compelled to arbitrate was a signatory or a non-signatory.[29] In *Comer v. Micor, Inc.*, the Ninth Circuit refused to apply the theory of equitable estoppel to compel an investor to arbitrate statutory claims that he sought to bring in court against an investment fund manager. The fund manager argued that the investor was required to arbitrate by arbitration clauses in the agreements between the fund manager and the trustee of the investor's retirement plans, to which the investor was not a party. This case thus arose in a context resembling the consumer and employment cases previously mentioned – a dispute between an individual and a corporation. The court did not rely on that circumstance, however, but on the absence of any agreement on the part of the investor to arbitrate. The Ninth Circuit went on to refuse to apply the doctrine of equitable estoppel, because there was "no evidence that [the investor] 'knowingly exploited the agreement[s] containing the arbitration clause[s] despite never having signed the agreement'.... Nor did he do so by bringing this lawsuit, which he bases entirely on [the statute]."[30]

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27. *Ibid.* at 131 (citations omitted), quoting *Smith/Enron Cogeneration Ltd. v. Smith Cogeneration Int'l, Inc.*, 198 F.3d 88, 97 (2d Cir.1999); *Thomson-CSF, S.A. v. American Arbitration Association*, 64 F.3d 773, 779 (2nd Cir. 1995); and *Choctaw Generation Ltd. P'ship v. Am. Home Assur. Co.*, 271 F.3d 403, 406 (2d Cir. 2001).

28. Professor Hanotiau correctly identifies the Second Circuit's decision in *Sarhank Group v. Oracle Corp.*, 404 F.3d 657 (2d Cir. 2005), as having gone too far in that direction. That case should be seen as an example of overreaching extraterritoriality, rather than as an appropriate application of the rules governing when a non-signatory may or may not be required to arbitrate.

29. *Comer v. Micor, Inc.*,436 F.3d 1098 (9th Cir. 2006).

30. *Ibid.* at 1102.

Our courts will still require signatories to arbitrate with non-signatories in appropriate circumstances.[31] The Eighth Circuit, for example, last year required a franchisor to arbitrate tort claims that it sought to bring in court against executives of the franchisee company that was the party to the contract with the franchisor that contained the arbitration clause.[32] The court explained that "[a] non signatory can enforce an arbitration clause against a signatory to the agreement ... when 'the relationship between the signatory and nonsignatory defendants is sufficiently close that only by permitting the nonsignatory to invoke arbitration may evisceration of the underlying arbitration agreement between the parties be avoided.'"[33] The court stressed in doing so that permitting the individuals to move the suit out of court and into arbitration was proper, because the franchisor "must rely on the written agreement" in making its claims against the non-signatory executives'".[34]

III. CONCLUSION

The forces that generate dozens of American court decisions a year concerning whether non-signatories may compel arbitration or be compelled to arbitrate continue to operate in the United States. The dramatic procedural differences between litigation and arbitration, and the higher-stakes nature of those differences, continue to fuel a desire on the part of many parties to be in a system other than the one that the underlying contracts may have specified, and our courts continue to be required to decide who (as opposed to what) may be required to go to arbitration.

While the basic rules of law have not changed, there does appear to be a trend over the last five or six years toward applying those rules differently, depending upon whether the party to be compelled has signed an arbitration agreement or not. If the party has agreed to arbitrate with anyone, our courts have continued to be willing to expand that agreement to embrace others. But they have been increasingly reluctant to use any of the theories available to force a party that has never agreed to arbitrate at all to do so.[35] Our decisions may not call the governing principle consent, but that would be as good a name for it as any.

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31. Some relatively non-controversial ones involve assumption by conduct, *Trippe Manufacturing Co. v. Niles Audio Corp.*, 401 F.3d 529 (3rd Cir. 2005); and incorporation by reference, *Keytrade USA, Inc. v. Ain Temouchant M/V in rem*, 404 F.3d 891 (5th Cir. 2005).
32. *CD Partners, LLC v. Grizzle*, 424 F.3d 795 (8th Cir. 2005).
33. *Ibid.* at 798.
34. *Ibid.*
35. *E.g. Zurich American Insurance Co. v. Watts Industries, Inc.*, 417 F.3d 682, 688 (7th Cir. 2005) (agency theory found insufficient to require non-signatory to arbitrate).