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Blurred Lines: Rethinking the Issue Of Consent by Non-Signatories

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SHUTTERSTOCK

Regardless of whether Robin Thicke's 2013 megahit "Blurred Lines" plagiarized Marvin Gayes' 1977 hit "Got To Give Up," the song's title provides an accurate description of what constitutes "consent" by a non-signatory in arbitration.

In recent years, U.S. courts have increasingly tended not only to enforce mandatory arbitration agreements, but also to compel arbitration even in instances where one of the parties did not sign an agreement to arbitrate.

Section 4 the Federal Arbitration Act (FAA) expressly gives the judiciary the power to compel parties "to proceed to arbitration in accordance with the terms of the arbitration agreement." Although consent is understood to be the *sine qua non* of arbitration, in the interests of judicial efficiency, courts have also compelled arbitration in situations not expressly within "the terms of the arbitration agreement." Sometimes non-signatories seek to take advantage of an agreement to arbitrate, either offensively (to commence an arbitration against a signatory) or defensively (to trump a court proceeding commenced by a signatory). Alternatively, a signatory to an arbitration agreement may attempt to bring a non-signatory within the agreement's reach, again either offensively or defensively.

Legal Theories

Courts have used six legal theories grounded in contract or agency law to permit non-signatories to arbitrate: incorporation by reference; assumption by conduct; third party beneficiary; agency; piercing

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the corporate veil; and equitable estoppel. The last ground has been increasingly used and has also been among the more controversial justifications for determining the fate of non-signatories.

Disputes involving non-signatories are inevitable in the context of business transactions that typically involve a complex web of interwoven agreements, multilayered legal obligations and the interposition of numerous related corporate and other entities. Early cases analyzing the rights of non-signatories were often associated with bills of lading and construction sub-contracts, or concerned defendants with close financial relationships such as parent/subsidiary or contribution/indemnity, or involved a surety or guarantor. Increasingly the rights of non-signatories have been at issue in a diverse range of matters, from reinsurance agreements to licensing contracts.

Application by the Courts

One commentator has warned about the courts turning arbitration clauses into "super- contracts" by applying special interpretive rules for arbitration clauses not applicable to other contracts. *See* Frankel, Richard, *The Arbitration Clause as Super Contract*, 91 Wash. U. L. Rev. 531 (2014). Another commentator has warned that equitable estoppel has become a dangerous doctrine as courts in different jurisdictions have applied it inconsistently to compel non-signatories to arbitrate disputes. *See* Christopher Driskill, Note, *A Dangerous Doctrine: The Case Against Using Concerted-Misconduct Estoppel to Compel Arbitration*, 60 Ala. L. Rev. 443 (2009).

Others have noted that a split currently exists at both the state and federal levels between expansive and restrictive applications of equitable estoppel, with the Second U.S. Court of Appeals falling into the former expansive interpretation camp. *See* Doug Uloth & Hamilton Rial, *Enforcing Arbitration Agreements Against Non-Signatories*, 65 Tex. B.J. 802 (Oct. 2002).

The recent decision, *Bankers Conseco Life Ins. v. Feuer*, 16 Civ. 7646, 2018 U.S. Dist. Lexis 43828 (SDNY March 13, 2018) follows other cases in the Second Circuit which have applied the doctrine of equitable estoppel in an expansive manner. Plaintiff insurance companies brought suit against the defendants, who were executives of a reinsurance company and a private investment firm, for fraudulently misrepresenting the financial condition and corporate structure of the signatory Beechwood Re Ltd (Beechwood) by claiming it had at least $100 million in capital, when in fact, those funds were under the control of another entity, Platinum Partners. In reliance on those representations, plaintiffs assigned $550 million in trust assets for investment to Beechwood, which were then used as a front as part of the widely publicized fraud scheme of Platinum Partners.

The reinsurance agreement signed by the corporate entities provided that "*all disputes or differences between the parties arising under or relating to this Reinsurance Agreement…shall be decided by arbitration*." Plaintiffs filed a demand for arbitration against the corporate entities and simultaneously filed a complaint against the individuals. The executives, non-signatories, moved to compel arbitration and stay the court proceedings. The plaintiffs argued that the "between the parties" language should be strictly construed while defendants argued that the agency relationship between themselves and Beechwood was sufficient to invoke the arbitration provision.

Judge Edgardo Ramos, applying the two pronged "intertwined-ness" test, granted the non-signatory defendants' motion and stayed the court proceeding, holding that non-signatories may invoke equitable estoppel to compel arbitration against signatories when the "issues the non-signatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed" *citing Choctaw Generation v. Am. Home Assur. Co.*, 271 F.3d 403, 404 (2d Cir. 2001).

The two prongs which must be examined: "(1) whether the signatory's claims arise under the same subject matter of the agreement and (2) whether the non-signatory has a 'close relationship' to signatory of the agreement." *Chase Mortg. Co.-West v. Bankers Tr. Co.*, 00 Civ. 8150, 2001 U.S. Dist. Lexis 6683 (SDNY May 18, 2001). Both prongs were met because the reinsurance agreements were significantly intertwined with the complaint's allegations and the defendants possessed the essential close relationship, which is centered on the role of the non-signatory defendants when the misconduct occurred.

Broader View

Other cases in the Second Circuit that have taken an even broader view of equitable estoppel include a pair of cases from the Southern District concerning tax shelters where the district court granted motions to compel arbitration based solely on the second prong of the *intertwinedness* test, concert of action and conspiracy by the defendants. *Carroll v. Leboeuf, Lamb, Greene & MacRae*, 374 F. Supp. 2d 375, 379 (SDNY 2005): *Camferdam v. Ernst & Young*, No. 02 Civ. 10100 (BSJ), 2004 WL 307292 at *6 (SDNY Feb 13, 2004). In both cases the plaintiffs' agreements with their tax advisor had an arbitration provision, but the plaintiffs' agreements with the law firm co-defendants, who also promoted the unlawful use of the tax shelter, did not.

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In *Camferdam*, after plaintiffs filed a complaint, the law firm moved to compel arbitration. The court compelled arbitration against all defendants, noting that "a civil conspiracy is a kind of partnership, in which each member becomes the agent of the other" and Plaintiffs' theory of liability "can only succeed if they prove …that all Defendants conspired and acted together." The court in *Carroll* went even further, noting that "[t]he fact that the claims against (the non-signatory) movants do not arise under the signatory agreements, while relevant, is but one factor to be considered in determining whether the claims are intertwined." The court also noted that "the standard which governs such situations look…not to evidence that the estopped party actually intended or expected that any dispute with the non-signatory would be subject to arbitration" but rather "[t]he doctrine therefore [depends] upon…considerations of adjudicative economy, not consent."

In another case, *Moss v. BMO Harris Bank*, 24 F. Supp. 3d 281 (E.D N.Y. 2014) regarding five payday usurious loans, the plaintiff borrowers chose to sue banks which were not the lenders but facilitated the loans through electronic transfers. The loan agreements between the borrowers and the banks which extended the loans contained an arbitration provision providing that the borrower needed to arbitrate not only with the lender but also its agents, servicers or any affiliated entities. The court granted the banks motion to compel arbitration.

Conclusion

Consent when applied to a non-signatory is, at best, a murky issue. Significant issues such as confidentiality, and efficiency of costs and time, often drive the decision whether to incorporate an arbitration provision into an agreement. Sometimes, the desire to stay out of the newspaper headlines in connection with acts of fraud and misconduct becomes the driving force for a non-signatory to seek to compel arbitration. In the cases discussed above, even in the face of RICO claims, the courts were unsympathetic to plaintiff signatories' arguments that the doctrine of "unclean hands" should bar the defendants' motions to compel arbitration. Courts seem more willing to expand the definition of consent when it is the non-signatory which seeks to compel arbitration. On the other hand, if a non-signatory is compelled to arbitrate against its wishes, concerns about the right to a jury trial and safeguards provided by trial courts are implicated.

Practitioners understand the need for specificity in drafting arbitration provisions. However, the focus is generally on what, where, when, and how. Many clauses now provide for, among other things, the number of arbitrators and selection criteria, what rules will govern, and the location. Practitioners should anticipate the lurking question of with whom one can arbitrate. What once seemed to be rendered obvious by a signature line is now often a blurred line. In arbitration, it may often take more than two to tango. While it may be impossible to consider all the parties that might fall under the umbrella of consent, some potential parties may be more visible than others. Anticipate the fight and tailor an arbitration provision that might help achieve your goals or, at least, reflect the signatories' intention with respect to who may or may not be scooped up in any future arbitration.