Binding Third Parties

Under the arbitration statutes, including the FAA and the New York Arbitration Act, an arbitration agreement need be written, but need not be signed by any of the parties, even the one against whom enforcement is sought. However, one cannot require a party to arbitrate simply because that party is directly involved in an arbitrable dispute between other parties. For instance, where a contractor properly initiates arbitration against an owner for additional expenses attributed to faulty specifications from the owner's architect, the owner cannot implead his architect into the arbitration absent an agreement to arbitrate with that architect.

There are times, however, when a so-called "non-signatory" (third party) to an agreement may nonetheless be deemed bound by a contract containing an arbitration clause. This typically implicates traditional principles of corporate, contract or agency law.

1. Successors-In-Interest. By virtue of a de jure or de facto merger, a company acquiring the stock and/or assets of another entity may be deemed a successor-in-interest to that entity's outstanding contractual obligations, including obligations to arbitrate.
2. Delegation With Assumption. An entity may sometimes delegate its duties under a contract to a third party which expressly or impliedly assumes those duties. If one of those duties is to arbitrate, the third-party is bound to do so at the behest of the counterparty.
3. Incorporation. A contract may expressly incorporate the provisions of another contract, made between different parties. If one such provision is an arbitration provision, the parties to the incorporating contract are subject to it.
4. Agency. Where an agent contracts on behalf of a principal so that the latter is bound by the contract, the principal is bound by any arbitral provision in that contract.
5. Third-Party Beneficiary. A third-party beneficiary to a contract can avail of its arbitral provision. This is fairly commonplace when a clearing broker, seeking to arbitrate against a customer, claims third party beneficiary status under a Customer Agreement between the customer and the introducing broker or the converse. Less frequently, a third- party beneficiary can have an arbitral provision enforced against it. Case law regarding third-party beneficiary status is complex and inconsistent.
6. "Piercing." Under "piercing of a corporate veil," a parent can sometimes be bound by an arbitral undertaking of its subsidiary.

§ 4.02 BINDING THIRD PARTIES

We have seen that arbitral statutes require written arbitral agreements, not ones *signed by* the parties or either of them. Still, that is a very different question than that of permitting or requiring third parties to arbitrate even though they are not party to the contract setting forth the undertaking to arbitrate. Such third parties will have some sort of relationship with at least one of the parties to the arbitral agreement.

Contract law governs here. Despite a pro-arbitrability bent, courts will not require a party to arbitrate who has not agreed in fact or by operation of law to do so. The fact that it would be efficient to bring an involved third party into an arbitration, in an impleader situation for example, is by no means enough to do so. Nonetheless, arbitral entitlements are relatively routinely extended to third-party beneficiaries and to those with "derivative" entitlements. Also, under principles of "piercing the corporate veil," a party may find itself obligated to honor the arbitral undertaking of a dominated closely held company or that of a highly controlled subsidiary. As a general proposition, it appears easier for a related third party to enforce an agreement to arbitrate than it is to enforce such an agreement against a related third party which does not wish to arbitrate. Can you see why?

Confusingly, cases sometimes reference third parties who may become bound to arbitrate as "non-signatories." It would be better to reference them as "non-parties" to the contract containing the agreement to arbitrate. The lack of signature, we have seen, is not really the issue.

Thomson-CSF v. American Arbitration Ass'n
United States Court of Appeals, Second Circuit, 1995.
64 F.3d 773.

- ALTIMARI, CIRCUIT JUDGE.

Plaintiff-appellant Thomson-CSF, S.A. ("Thomson") appeals from a judgment entered in the United States District Court for the Southern District of New York (Keenan, J.), denying its request for declaratory and injunctive relief and granting defendant-appellee Evans & Sutherland Computer Corporation's ("E & S") cross-motion to compel arbitration. Thomson asserts that the district court improvidently compelled it to arbitrate against E & S based upon an arbitration agreement between E & S and Thomson's subsidiary, to which Thomson was not a signatory. Because, under ordinary principles of contract and agency law, Thomson cannot be said to have voluntarily submitted to arbitrate its disputes with E & S, we reverse the judgment of the district court and remand for proceedings consistent with this opinion.

BACKGROUND

Rediffusion Simulation Limited ("Rediffusion") was a British company engaged in the business of building flight simulators for the training of pilots. In 1986, Rediffusion entered into a "Working Agreement" with E & S, located in Salt Lake City, Utah. Under the Working Agreement, Rediffusion agreed to purchase computer-generated image equipment (the computer "brain" of the flight simulator) exclusively from E & S and to use its best efforts to market those systems containing E & S equipment; in return, E & S agreed to supply its imaging equipment only to Rediffusion.

Subsequent to entering into the Working Agreement, Rediffusion was sold to Hughes Aircraft Company. Hughes amended and extended the Working Agreement between Rediffusion and E & S. On December 31, 1993, Hughes sold Rediffusion to Thomson, which renamed it Thomson Training and Simulation Limited. Prior to purchasing Rediffusion, Thompson maintained a division engaged in the business of building flight simulation equipment (the Training and Simulation Systems Division) into which it began integrating Rediffusion.

At the time Thomson began publicly contemplating the acquisition of Rediffusion, E & S informed Thomson that, if it purchased Rediffusion, E & S intended to bind Thomson and its flight simulation division to the Working

Agreement. Specifically, E & S told Thomson that upon purchasing Rediffusion both Rediffusion and Thomson's Training and Simulation Systems Division would be required to purchase all needed computer-generated image equipment from E & S. In response, Thomson wrote to E & S seeking to have it waive those provisions of the Working Agreement that E & S believed to be binding upon Thomson. Thomson did not, however, concede that it would be bound by Rediffusion's Working Agreement. In fact, when it became clear that Thomson and E & S could reach no agreement prior to Thomson's acquisition of Rediffusion, Thomson explicitly informed E & S that it was not adopting the Working Agreement and did not consider itself bound by Rediffusion's Agreement which it had neither negotiated nor signed.

DISCUSSION

Arbitration is contractual by nature--"a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582 (1960). Thus, while there is a strong and "liberal federal policy favoring arbitration agreements," Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 625 (1985) (quotations omitted), such agreements must not be so broadly construed as to encompass claims and parties that were not intended by the original contract. "It does not follow, however, that under the [Federal Arbitration] Act an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision." Fisser v. International Bank, 282 F.2d 231, 233 (2d Cir. 1960); see also Deloitte Noraudit A/S v. Deloitte Haskins & Sells, U.S., 9 F.3d 1060, 1064 (2d Cir. 1993). This Court has made clear that a nonsignatory party may be bound to an arbitration agreement if so dictated by the "ordinary principles of contract and agency." McAllister Bros., Inc. v. A & S Transp. Co., 621 F.2d 519, 524 (2d Cir. 1980); see also A/S Custodia v. Lessin Int'l, Inc., 503 F.2d 318, 320 (2d Cir. 1974).

A. *Traditional Bases for Binding Nonsignatories.*

This Court has recognized a number of theories under which nonsignatories may be bound to the arbitration agreements of others. Those theories arise out of common law principles of contract and agency law. Accordingly, we have recognized five theories for binding nonsignatories to arbitration agreements: 1) incorporation by reference; 2) assumption; 3) agency; 4) veil-piercing/alter ego; and 5) estoppel. The district court properly rejected each of these traditional theories as sufficient justification for binding Thomson to the arbitration agreement of its subsidiary.

1. Incorporation by Reference.

A nonsignatory may compel arbitration against a party to an arbitration agreement when that party has entered into a separate contractual relationship with the nonsignatory which incorporates the existing arbitration clause. As the district court noted, E & S has not attempted to show that the Working Agreement was incorporated into any document which Thomson adopted. Thus, Thomson cannot be bound under an incorporation theory.

2. Assumption.

In the absence of a signature, a party may be bound by an arbitration clause if its subsequent conduct indicates that it is assuming the obligation to arbitrate. See Gvozdenovic v. United Air Lines, Inc., 933 F.2d 1100, 1105 (2d Cir.) (flight attendants manifested a clear intention to arbitrate by sending a representative to act on their behalf in arbitration process), cert. denied, 502 U.S. 910 (1991); Keystone Shipping, 782 F. Supp. at 31; In re Transrol Navegacao S.A., 782 F. Supp. 848, 851 (S.D.N.Y. 1991). While Thomson was aware that the Working Agreement purported to bind it as an "affiliate" of Rediffusion, at no time did Thomson manifest an intention to be bound by that Agreement. In fact, Thomson explicitly disavowed any obligations arising out of the Working Agreement and filed this action seeking a declaration of non-liability under the Agreement. Accordingly, it cannot be said that Thomson assumed the obligation to arbitrate.

3. Agency.

Traditional principles of agency law may bind a nonsignatory to an arbitration agreement. See Interbras Cayman Co. v. Orient Victory Shipping Co., S.A., 663 F.2d 4, 6–7 (2d Cir. 1981). Because the Working Agreement was entered into well before Thomson purchased Rediffusion, Thomson could not possibly be bound under an agency theory.

4. Veil Piercing/Alter Ego.

In some instances, the corporate relationship between a parent and its subsidiary are sufficiently close as to justify piercing the corporate veil and holding one corporation legally accountable for the actions of the other. As a general matter, however, a corporate relationship alone is not sufficient to bind a nonsignatory to an arbitration agreement. Nonetheless, the courts will pierce the corporate veil "in two broad situations: to prevent fraud or other wrong, or where a parent dominates and controls a subsidiary." Carte Blanche (Singapore) Pte., Ltd. v. Diners Club Int'l, Inc., 2 F.3d 24, 26 (2d Cir. 1993); see also Wm. Passalacqua Builders, Inc. v. Resnick Developers S., Inc., 933 F.2d 131, 138–39 (2d Cir. 1991) ("Liability . . . may be predicated either upon a showing of fraud or upon complete control by the dominating corporation that leads to a wrong against third parties."). While the district court below noted that, "[c]ounsel for E & S also denied at oral-argument that its claim was properly articulated as veil-piercing," E & S now asserts that an alter ego relationship between Thomson and Rediffusion may exist. While E & S concedes that it can make no showing of fraud, it argues that Thomson sufficiently dominated Rediffusion as to justify veil piercing.

Veil piercing determinations are fact specific and "differ[ ] with the circumstances of each case." American Protein Corp. v. AB Volvo, 844 F.2d 56, 60 (2d Cir.). This Court has determined that a parent corporation and its subsidiary lose their distinct corporate identities when their conduct demonstrates a virtual abandonment of separateness. See *Carte Blanche*, 2 F.3d at 29 ("No bank accounts, offices, stationery, transactions, or any other activities were maintained or carried on in the name of [the subsidiary]."); *Wm. Passalacqua*, 933 F.2d at 139 (corporate veil is pierced where, among other things, parent and subsidiary 1) share common office and staff; 2) are run by common officers; 3) intermingle funds; 4) do not deal at arm's length with each other; and 5) are not treated as separate profit centers); see also Walter E. Heller & Co. v. Video Innovations, Inc., 730 F.2d 50, 53 (2d Cir. 1984) (absence of corporate formalities relevant factor in piercing corporate veil). "[T]he factors that determine the question of control and domination are less subjective than 'good faith'; they relate to how the corporation was actually operated." *Carte Blanche*, 2 F.3d at 28–29.

E & S has not demonstrated that Thomson exerted the degree of control over Rediffusion necessary to justify piercing the corporate veil. While the district court found that "Thomson has common ownership with [Rediffusion]; that Thomson actually controls [Rediffusion]; . . . [and] that Thomson incorporated [Rediffusion] into its own organizational and decision-making structure," the district court did not find an abandonment of the corporate structure. E & S has not shown an absence of corporate formalities, nor has it shown an intermingling of corporate finances and directorship. Rather, as the district court found, Rediffusion continued to function as a distinct entity closely incorporated into the existing corporate structure of its parent company, Thomson. Accordingly, in light of the totality of the circumstances, Thomson cannot be bound by Rediffusion's arbitration agreement under a veil piercing/alter ego theory.

5. Estoppel.

The circuits have been willing to estop a *signatory* from avoiding arbitration with a nonsignatory when the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed . . . . In the line of cases discussed above, the courts held that the parties were estopped from avoiding arbitration because they had entered into written arbitration agreements, albeit with the affiliates of those parties asserting the arbitration and not the parties themselves. Thomson, however, cannot be estopped from denying the existence of an arbitration clause to which it is a signatory because no such clause exists. At no point did Thomson indicate a willingness to arbitrate with E & S. Therefore, the district court properly determined these estoppel cases to be inapposite and insufficient justification for binding Thomson to an agreement that it never signed.

* * * *

B. *The District Court's Hybrid Approach.*

Despite properly determining that E & S's claims did not fall within any of the traditional theories for binding a nonsignatory, the district court stated, "[n]evertheless, E & S asserts that the Court may bind Thomson based on its conduct in 'voluntarily bec[oming] . . . an affiliate,' on the degree of control Thomson exercises over [Rediffusion], and on the interrelatedness of the issues.

This Court agrees." (citations omitted). In so doing, the district court improperly extended the law of this Circuit and diluted the protections afforded nonsignatories by the "ordinary principles of contract and agency." *McAllister*, 621 F.2d at 524. A nonsignatory may not be bound to arbitrate except as dictated by some accepted theory under agency or contract law.

* * * *

The district court below improperly extended the limited theories upon which this Court is willing to enforce an arbitration agreement against a nonsignatory. The district court's hybrid approach dilutes the safeguards afforded to a nonsignatory by the "ordinary principles of contract and agency" and fails to adequately protect parent companies, the subsidiaries of which have entered into arbitration agreements. Anything short of requiring a *full* showing of some accepted theory under agency or contract law imperils a vast number of parent corporations.

CONCLUSION

Accordingly, the judgment of the district court is reversed and remanded for proceedings consistent with the foregoing.

NOTE:

1. Had Rediffusion been merged into Thomson, Thomson would, by operation of law, become a successor in interest to Rediffusion's outstanding contractual obligations, including that of having to arbitrate under the contract at issue. Where one entity purchases another's assets but there is no actual merger, the purchaser, under limited circumstances, may still be a successor in interest. This is covered by the "de facto merger" doctrine. *See* generally, Cargo Partners AG v. Albatrans, Inc., 352 F.3d 41 (2d Cir. 2003).

Shaffer v. Stratton Oakmont, Inc.
United States District Court, N.D. Ill., 1991.
765 F. Supp. 365.

- NORGLE, DISTRICT JUDGE.

Before the court is the motion of defendants Stratton Oakmont, Inc. and Robert Koch for a stay pending arbitration and for a protective order staying discovery. For the reasons discussed below, this motion is denied.

FACTS

In February of 1990, plaintiff John E. Shaffer ("Shaffer") opened an account with Stratton Oakmont, Inc. ("Stratton"), a securities broker and dealer, through Robert Koch ("Koch"), an employee of Shaffer. Unlike those securities brokers known in the industry as "self-clearing" brokers, Stratton is an "introducing" broker (also known as a "corresponding" broker), and does not perform its own "clearing" services. Stratton must contract with a "clearing broker" in order to consummate the securities transactions which it recommends to its customers. Pursuant to opening his account with Stratton, Shaffer signed a brokerage account agreement (the "Brokerage Agreement") provided by Ameritrade, Inc., Stratton's clearing broker.

The Brokerage Agreement consists of several pages of pre-printed forms. The top of the first page of the Brokerage Agreement contains Ameritrade's name in large letters and bold print and provides a space for identification of the introducing broker. This space, however, is left blank on the form. On the bottom of the page, immediately above the signature line on which Shaffer's signature appears, is printed: "This brokerage account agreement contains a pre-dispute arbitration clause in form AM-9-89, section 1, paragraph 7." The arbitration clause referred to in this notice appears subsequently in the agreement, and reads, in relevant part:

> Any controversy between *Ameritrade, Inc. and me* arising out of or relating to this Agreement or the breach thereof may be settled by arbitration . . . .

Neither defendant's name appears anywhere in the agreement.

* * * *

Plaintiff contends that on June 27, 1990, without his express consent, defendants purchased 30,000 shares of Ventura Motion Picture Group Stock on his account, at $8 per share. Defendants contend that plaintiff had agreed to purchase the stock but failed to make a timely margin deposit payment in order to secure the acquisition. Defendants then sold the stock at $7 per share, resulting in a loss of $30,000 on the deal. In order to cover the loss, defendants liquidated the remaining stocks in plaintiff's account and returned to plaintiff the remaining balance.

DISCUSSION

The parties agree that the sole question at issue here is whether defendants Stratton and Koch have standing to compel plaintiff to arbitrate his grievances with them pursuant to the arbitration provision in the Ameritrade Brokerage Agreement. In the memorandum in support of its motion for stay, defendants acknowledge that there is some division of authority on this question. They argue that the better rule resolves all doubts in favor of arbitration. Defendants further argue that they should be permitted to invoke the arbitration provision under either an agency theory or a third party beneficiary theory. Plaintiff, on the other hand, argues that the defendants are not parties to the Brokerage Agreement and have no standing to benefit from its arbitration provision. He cites to a number of cases in which courts have refused to apply the third party beneficiary doctrine or the principles of agency to permit an introducing broker to benefit from an arbitration agreement signed only by the clearing broker and the investor. As a policy issue, plaintiff also argues that it would be unfair for the court to compel him to arbitrate his dispute with defendants when he never consented to relinquish his right to be heard in federal court.

* * * *

Although all relevant authorities will not compel arbitration absent evidence of the parties' agreement to arbitrate, they appear somewhat divided on whether to imply such an agreement in the absence of an express contract or understanding. Most courts addressing this issue have held that a securities investor will not be deemed to have agreed to arbitration (and thus, to have waived its right to federal jurisdiction) absent evidence of its actual intent to be so bound. Other courts, however, appear to hold that consent may be implied in law, either because the introducing broker is deemed to be the disclosed agent of the clearing broker, *see Okcuoglu*, or because the introducing broker is viewed as a third party beneficiary to the written agreement between the investor and the clearing broker. See Cauble v. Mabon, Nugent & Co., 594 F. Supp. 985 (S.D.N.Y. 1984).

In the present case, there has been no showing that Shaffer knowingly consented to give Stratton and Koch the power to compel arbitration which it gave to Ameritrade. The fact that Shaffer never communicated directly with Ameritrade does not establish that Shaffer intended for the terms of the Ameritrade Brokerage Agreement, which made no mention of defendants, to apply equally to them. Significantly, nothing in defendants' pleadings indicates an *intention* by Shaffer to consent to arbitrate his disputes with defendants.

Rather, defendants merely argue that constructive consent must be implied from defendants' relationship with Ameritrade. Significantly, none of the cases cited by defendants support the position that a court may imply constructive consent in the absence of an investor's actual intention (either express-i.e., a written or oral statement, or implied-i.e., from conduct) to be bound by arbitration. Because an agreement to arbitrate entails the abrogation of an investor's important procedural right to be heard in federal court, the court will not imply an investor's "constructive" consent based solely upon the relationship between the introducing and clearing brokers.

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IT IS SO ORDERED.