AGENCY: BINDING NONSIGNATORIES

TO ARBITRATION CLAUSES

By

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I. Introduction

Given that arbitration is a creature of contract, it is easy to posit that a party that has not signed a contract with an arbitration clause has no right or obligation to arbitrate pursuant to that contract. However, there are certain exceptions to this rule: "[T]here are five doctrines through which a non-signatory can be bound by arbitration agreements entered into by others: (1) assumption; (2) agency; (3) estoppel; (4) veil piercing; and (5) incorporation by reference."[1] Further, "[n]onsignatories of a contract . . . may compel arbitration or be subject to arbitration if the nonparty is an agent of a party . . . ."[2] For present purposes:

> Agency is "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."[3]

The purpose of this article is to explore: (1) some of the case law in which the agency exception has and has not been found to apply; and (2) various multi-party disputes which might be consolidated and resolved more efficiently though use of this exception.

II. Agency Exception Found to Apply

Pritzker v. Merrill Lynch, Pierce Fenner & Smith, 7 F.3d 1110 (3rd Cir. 1993) was a suit by trustees of a pension plan against Merrill Lynch, a subsidiary corporation that provided advisory services to pension plans

and the individual financial consultant who handled this account. The trustees had signed a cash management account agreement with Merrill Lynch, but the subsidiary corporation and financial consultant were not parties to that agreement. The agreement contained an arbitration clause.

The trustees objected to the motion to compel joinder of the financial consultant and the subsidiary to the arbitration but the court rejected these objections:

> Under traditional agency theory, [the financial consultant] is subject to contractual provisions to which [Merrill Lynch] is bound. Because a principal is bound under the terms of a valid arbitration clause, its agents, employees and representatives are also covered under the terms of such agreements. . . .
> For analogous reasons, we find that the claims against [the subsidiary], the corporate sister of Merrill Lynch, likewise fall within the scope of the arbitration agreements. . . . [I]t is evident from the record that [the subsidiary] was obligated to perform certain services in connection with the Accounts opened by the Trustees. . . .
> Count II of the [Trustees'] amended complaint asserts that [the subsidiary] is liable to the Trustees for "its knowing participation in breaches of fiduciary duties owed to the plan." The Trustees' own theory of liability demonstrates that [the subsidiary's] interests are directly related to, if not predicated upon, [Merrill Lynch's] conduct.[4]

A claims adjuster sued its errors and omissions insurer and the MGA that issued the policy, which contained an arbitration clause, in Greene v. Great American E & S Ins. Co., 321 F.Supp.2d 717 (D. N.C. 2004). The defendants moved to compel arbitration and plaintiff resisted arbitration with the MGA on the basis that it was not a party to the insurance policy. The court allowed joinder of the MGA based on the agency exception.

In Farmers & Merchants Bank v. Hamilton Hotel Partners, 702 F.Supp. 1417 (W.D. Ark. 1988), Johnson purchase an interest in a partnership in his own name pursuant to an agreement that required arbitration of any disputes with respect to any accounts that he "may open or reopen." Later, he purchased an additional interest in the name of the bank as trustee for Johnson's self-directed IRA. When a dispute arose over the second account, the bank sued and the partnership moved to compel arbitration. The court ordered that the dispute be arbitrated:

> It would advance neither judicial economy nor the purposes of the federal arbitration act to allow the plaintiff [bank] to

> disavow the relationship. Mr. Johnson and the IRA act as one.[5]

A general contractor filed an arbitration against a limited partnership and the general partner thereof under the arbitration clause of a contract between the contractor and the limited partnership in Keller Construction Co. v. Kazem Kashani, 220 Cal. App.3d 222 (Ct. App. 1990). The general partner declined to participate in the arbitration and panel issued an award against him. The general partner sought to vacate the award. The court declined to so vacate finding that under California law, the general partner is the agent of a limited partnership.

Harris v. Superior Court of Los Angeles County, 188 Cal. App.3d 475 (Ct. App. 1986) involved a medical malpractice claim against a hospital and its employee physician. The plaintiffs were enrollees in a prepaid health care plan with the hospital which called for arbitration of disputes involving the hospital and its employees. In this case, the plaintiffs were seeking to compel arbitration and the physician was resisting. The court granted the motion to compel thus enforcing the arbitration clause against the nonsignatory physician.

III. **Agency Except Found not to Apply**

Bridas entered a joint venture with Turkmenneft, the latter being owned by the Government of Turkmenistan in Bridas Sapic v. Government of Turnmenistan, 345 F.3d 347 (5th Cir. 2003). When a dispute arose, Bridas tried to compel arbitration against the Government under the arbitration clause in the joint venture agreement with Turmenneft arguing that Turmenneft was the agent of the Government. Bridas cited various evidence in support of its argument including a Government guarantee of the obligations of Turmenneft and a passage in the joint venture agreement that the interests, rights and obligations of the Government are represented by Turmenneft. The court did not find this evidence sufficient to prove an agency relationship and added:

> We are simply unable to conclude that the parties, one a multi-national corporation who has negotiated joint venture agreements in the past, and the other, a sovereign nation, both represented by able counsel, intended Turkmenneft to sign the [joint venture agreement] as an agent of the Government in the absence of clearer language to that effect.[6]

Mutual Benefit Life Ins. Co. v. Zimmerman, 783 F.Supp. 853 (D.N.J. 1992) was the consolidation of four suits involving a reinsurance pool, insurers which ceded to the pool, the pool manager, a third party administrator, several intermediaries and brokers and certain principals in the non-insurance company entities. The dispute centered around the authority, or lack thereof, of the pool manager assuming certain MET business. The only arbitration clause was in the

management agreement between the pool manager and the pool members. The intermediaries and brokers moved to compel arbitration of these various claims under the management agreement. The court ruled that the movants had not established an agency relationship that would justify requiring nonsignatories to arbitrate:

> To determine whether an agency relationship exists, courts look to the terms of the agreement and the allegations of the complaint. In this case, the Movants are not defined as agents in the Management Agreement. The Movants' relationship to the Reinsurers arose because they procured the MET Business which Zimmerman, as the 1998 pool manager, accepted under the Reinsurance Agreements. The Movants are allegedly responsible for the Ceding Companies' decisions to insure MET Business. . . . These allegations, however, do not establish that the Movants, as provided for or contemplated under the Management Agreement, were agents of the 1988 Pool Members or Zimmerman Line Slip. Moreover, the Movants have not presented facts to support their allegations of an agency relationship.[7]

Whether or not the husband of the owner of the house could be bound to an arbitration provision in a remodeling contract signed only by the wife was the issue in Ellsworth v. American Arbitration Association, 148 P.3d 983 (Utah 2007). The court overturned the grant of summary judgment compelling arbitration since the martial relationship does not necessarily connote agency and there were too many facts in dispute for the court below to rule against the husband.

IV. **Opportunities for Consolidation**

Agents of various types are ubiquitous in insurance and reinsurance transactions. This offers the opportunity to consolidate multi-party disputes pursuant to arbitration clauses which are very common in reinsurance agreements but less so in policies and agency agreements. This can save considerable time and money and provide an expert panel to consider all aspects of the dispute. The types of disputes which might be consolidated include:

- Insured v. Agent and Insurer
- Insurer v. Insured and Broker
- Insured v. Insurer and TPA
- Reinsurer v. Cedent and Intermediary
- Reinsurer v. Cedent and MGU
- Cedent v. Reinsurer and Intermediary
- Cedent v. Reinsurer and MGU

V. Caveats to Consolidation

Regardless of whether or not the agency exception applies, the dispute itself must be arbitrable under the relevant contract. As third (or more) parties are brought into the mix, it becomes more likely that the arbitration clause may not cover all of the claims among the parties. Arbitration clauses vary considerably in scope *i.e.* "all disputes related to this contract" is quite a bit broader than "all disputes arising under this contract."

A case in point is Mutual Benefit Life Ins. Co. v. Zimmerman, 783 F.Supp. 853 (D.N.J. 1992) which is described in § III, *supra*. There, the arbitration clause in the pool management agreement covered "any dispute or difference hereafter arising with reference to the interpretation, application or other effect of this Agreement . . . ." The court found that this language did not cover RICO, fraud and conspiracy to defraud claims by pool members against the principal for the pool manager, intermediaries and brokers but did cover breach of common law fiduciary duty against the principal for the pool manager.

VI. Conclusion

Courts will commonly recognize an exception to the rule that nonsignatories to a contract containing an arbitration clause cannot enforce such a clause for a corporation's acknowledged employees, agents and representatives. In other situations, the court will examine the contract at issue, the allegations of the complaint and the relationship to the signatories to determine whether the status of the entity in question rises to the level of "agent." If so, the entity may enforce the arbitration clause or have it enforced against them.

Use of the agency exception provides opportunities to consolidate multi-party disputes in order to same time and money and have all aspects of the dispute resolved by an expert panel. However, a narrow arbitration clause can be a problem when attempting to consolidate with respect to issues collateral to contract at issue.

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1 Zurich American Ins. Co. v. Watts, 417 F.3d 682, 687 (7th Cir. 2005).
2 Mutual Benefit Life Ins. Co. v. Zimmerman, 783 F.Supp. 853, 865 (D. N.J. 1992).
3 Bridas Sapic v. Turkmenistan, 345 F.3d 347, 356-7 (5th Cir. 2003) quoting the Restatement (Second) of Agency.
4 7 F.3d 1110, 1121-2 (internal citations omitted.
5 702 F.Supp. 1417, 1425-6.
6 345 F.3d 347, 358.
7 783 F.Supp. 853, 866 (internal citations omitted.