EQUITABLE ESTOPPEL: 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]

The policy behind the equitable estoppel exception has been articulated as follows:

> The purpose of the doctrine is to prevent a plaintiff from, in effect, trying to have his cake and eat it too; that is, from "relying on the contract when it works to [his] advantage [by establishing the claim], and repudiating it when it works to [his] advantage [by requiring arbitration]."[2]

The purpose of this article is to explore some of the case law in which the equitable estoppel exception has been applied when: (1) a nonsignatory is attempting to force a signatory to arbitrate; or (2) a signatory is attempting to force a nonsignatory to arbitrate.

II. Nonsignatories Attempting to Force a Signatory to Arbitrate

The Fourth Circuit, quoting the Eleventh Circuit, stated the rule for this fact situation as follows:

> [E]quitable estoppel allows a nonsignatory to compel arbitration in two different circumstances. First, equitable estoppel applies when the signatory to a written agreement containing an arbitration clause must "rely on the terms of the written agreement in asserting [its] claims" against the nonsignatory. When each of a signatory's claims against a nonsignatory "makes reference to" or presumes the existence of' the written agreement, the signatory's claims "arise [] out of and relate []directly to the [written] agreement," and arbitration is appropriate. Second, "application of equitable estoppel is warranted . . . when the signatory [to the contract containing the arbitration clause] raises allegations of . . . substantially interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract."[3]

The fact situation of that case involved a mortgage agreement between a borrower and a lender that contained an arbitration clause and mortgage insurance for the benefit of the buyer which did not. The plaintiff's alleged that the mortgage insurer charged excessive rates due to false information in a credit report and failed to comply with the Fair Credit Reporting Act. The court rejected the argument that the premium issue was intertwined with the mortgage agreement, even though the mortgage required the borrower to obtain mortgage insurance, and found that the equitable estoppel exception did not apply.

In Re Humana, Inc, 285 F.3d 971 (11th Cir. 2002) involved physicians, some of whom had contracts with HMOs which contained arbitration clauses. These physicians brought suit against the HMOs alleging, among other things, RICO violations. The court denied HMO's motion to compel arbitration on the basis of equitable estoppel:

> Here, the doctors' suit does not rely upon or presume the existence of an underlying contract; the RICO claims in this case are based on a statutory remedy Congress has provided to any person injured as a result of illegal racketeering activities. This remedy stands apart from any available remedies for breach of contract, and clearly is not "intimately founded in and intertwined with the underlying contract obligations."[4]

An investment brokerage agreement with an arbitration clause was involved in Spurlock v. Life Ins. Co. of Virginia et al., 2000 U.S. Lexis 20738 (M.D. Ala.). The broker sold several insurance policies to the plaintiff who later sued the insurers and their agent, the broker, for misrepresentations concerning the insurance. The court granted the insurers motion to compel arbitration on the basis the actions and liability of the insurers and the broker were substantially interdependent and concerted.

In Staples v. The Money Tree, 936 F.Supp. 856 (M.D. Ala. 1996) the plaintiff obtained a car loan from a lender which also sold her several credit insurance products. When her car was totaled, the credit property insurance paid off the loan. The plaintiff later sued the lender and the insurers alleging that she had not received return premiums which were due to her. The insurers made a motion to compel arbitration based on the arbitration clause in the loan agreement. The court granted the motion on the basis that the plaintiff's claims against the insurers were derivative of those against the lender i.e. if she had no claim against the lender, she had no claim against the insurers.

Energy Transport agreed to ship carbon black feed stock to Thai Tokai pursuant to a charter party agreement with Oilmar which contained an arbitration clause in Underwriters at Lloyd's v. M/T San Sebastian et al., 2007 U.S. Dist. Lexis 24817 (N.D. Ga.). When the cargo was damaged the purchaser and its insurer filed a motion to compel arbitration of their claim against Oilmar on the basis of equitable estoppel. However, the court denied the motion on the basis that Oilmar had made no claim against the purchaser or its insurer and, therefore, was not using the contract as a sword against the purchaser or its insurer.

Limited Brands, Inc. v. Peerless Ins. Co., 2006 U.S. Dist. Lexis 81762 (E.D. Pa.) involved a contract by which Valco agreed to renovate Limited's store and pursuant thereto, Valco purchased an insurance policy naming Limited as an additional insured on the contract. The renovation contract contained an arbitration clause but the policy did not. When Limited brought suit against Valco and the insurer for indemnification with respect to an injured worker, the insurer moved to compel arbitration. The court ruled that the relevant facts did not support equitable estoppel.

III. Signatories Attempting to Force a Nonsignatory to Arbitrate

One court has described the legal standard for equitable estoppel under these factual circumstances as follows:

> A non-signatory is estopped from avoiding arbitration if it knowingly seeks the benefits of the contract containing the arbitration clause. For example, a third-party beneficiary of a contract is bound by the contract's arbitration provision. . . .
> In order to compel a non-signatory to arbitrate under this theory, the nonsignatory party must receive a "direct benefit" from the contract containing the arbitration provision. . . .
> In considering whether a non-signatory party has received a "direct benefit" from a contract, some courts have relied on the non-signatory's own allegations regarding it relationship with the contract. . . .
> The principle that a party cannot use its relationship with a contract to allege liability but then disavow the arbitration provision in the

> contract is consistent with the notion that "the doctrine of estoppel prevents a party from having it both ways."[5]

American Bureau of Shipping v. Tencara Shipyard S.P.A., 170 F.3d 349 (2nd Cir. 1999) involved defective construction of a yacht. The shipyard had obtained a "classification" for the yacht from the America Bureau of Shipping ("ABS") which entails a certification of the design and construction under international safety conventions. The classification contract was between the shipyard and ABS and contained an arbitration clause. When the yacht was damaged in a cruise shortly after it was launched, the shipyard, the owner and the owner's insurer sued ABS. ABS moved to compel the nonsignatories (the owner and its insurer) to arbitrate. The court granted the motion on the basis that the nonsignatories obtained a direct benefit from the classification, namely significantly lower insurance rates and the ability to sail under the French flag.

In Zurich American Ins. Co. v. Watts and Jones, 417 F.3d 682 (7th Cir. 2005) Zurich insured both Watts and its subsidiary, Jones. Watts, but not Jones, entered into deductible agreements with Zurich and these agreements contained arbitration clauses. When a dispute arose over deductibles, Zurich moved to compel Jones to arbitrate arguing equitable estoppel since Jones had benefited from the insurance policy. The court denied the motion ruling:

> Jones has not sought to enforce any rights it has under the deductible agreements, and in fact there would be no benefit to Jones under those agreements. Even assuming that Jones has benefited from the deductible agreements by paying lower insurance premiums based on the deductibles, this benefit is too attenuated and indirect to force arbitration under an estoppel theory.[6]

NICO was the reinsurer of Seaton and Stonewall and objected to their appointment of Castlewood as their runoff administrator in Castlewood (US) Inc., et al. v. National Indemnity Co., 2006 U.S. Dist Lexis (S.D.N.Y.). The reinsurance agreement contained an arbitration clause but Castlewood had not assumed any obligations hereunder. Nonetheless, NICO sought to compel Castlewood to participate in an arbitration under an equitable estoppel theory. The court denied the motion to compel ruling that the benefit to Castlewood of the reinsurance agreement was too indirect for the estoppel rule to apply.

Program business provided the factual backdrop for International Ins. Agency Services LLC v. Revios Reinsurance U.S., Inc., 2007 U.S. Lexis 2229 (N.D. Ill.). A managing general underwriter ("IIS") wrote group term life insurance through a fronting company ("CLIC") which ceded the risk to Revios which retroceded some of the risk to Harbour, an affiliate of IIS. When Revios attempted to cancel its assumption from CLIC and its retrocession to Harbour, IIS sued alleging damages to both IIS and Harbour. Revios moved to compel IIS to arbitrate under

the arbitration clauses in both its incoming and outgoing reinsurance agreements. The court granted the motion:

> IIS relies on the reinsurance and retrocession agreements to show that Revios acted improperly even though IIS is not a party to either agreement. IIS cannot have it both ways. If it is going to use its relationship to the parties in the agreements to create standing then it must also submit to the arbitration provision in the agreement. . . . The court is unable to see how IIS can litigate its claims without proving that Revios breached or attempted to breach the agreements containing the arbitration provisions. . . . Furthermore, IIS' complaint demonstrates that it received – and expected to continue to receive – a direct benefit from these agreements.[7]

IV. Conclusion

The legal rules with respect to equitable estoppel appear to be as follows: (1) a nonsignatory may require a signatory to arbitrate when the signatory's claims against the nonsignatory are based on the relevant contract or involve interdependent or concerted wrongful activities on the part of a signatory and a nonsignatory; and (2) a signatory may require a nonsignatory to arbitrate when the nonsignatory receives a direct benefit from the relevant contract. Obviously, the application of such rules varies with the factual circumstances. However, there is a substantial amount of case law for the practitioner to use as precedent.

ENDNOTES

1 Zurich American Ins. Co. v. Watts, 417 F.3d 682, 687 (7th Cir. 2005).
2 In Re Humana, Inc et al., 285 F.3d 971, 976 (11th Cir. 2002). Internal citations omitted.
3 Brantley v. Republic Mortgage Ins. Co., 424 F.3d 392, 395-6 (4th Cir. 2005) quoting MS Dealer Serv. Corp v. Franklin, 177 F.2d 942, 947 (11th Cir. 1999).
4 285 F.3d 971, 976. Internal citations omitted.
5 International Ins. Agency Services, LLC v. Revios Reinsurance U.S., Inc., 2007 U.S. Dist. Lexis 22229 (N.D. Ill.). *10-13. Internal citations omitted.
6 417 F.3d 682 at 687.
7 2007 U.S. Dist. Lexis 22229 *15 – 16.