Extending Arbitration Agreements to Bind Non-signatories

By William D. Gilbride Jr. and Erin R. Cobane

The Federal Arbitration Act (FAA), 9 USC 1 *et seq.*, codifies a federal policy in favor of arbitration over litigation.[1] "The [FAA] provides that if a party petitions to enforce an arbitration agreement, '[t]he court shall hear the parties, and upon being satisfied of the making of an agreement for arbitration…shall make an order directing the parties to proceed to arbitration[.]'"[2] Similarly, Michigan state policy favors arbitration of claims.[3] The Michigan Court of Appeals has recognized a presumption of arbitrability "unless it may be said with positive assurance that the arbitration clause is not susceptible to an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage."[4]

Although arbitration is a matter of contract[5] and an arbitration provision of the agreement cannot be imposed on a party which was not legally or factually a party to the agreement,[6] both state and federal courts have identified circumstances in which a non-signatory will be forced to arbitrate claims.[7] While the FAA preempts state law that invalidates arbitration agreements, 9 USC 2 recognizes that enforceability of an arbitration agreement may be decided on the basis of state contract law.[8] Various state and federal courts have recognized five principles of contract law that allow for an arbitration agreement to be enforced against a non-signatory: incorporation by reference, assumption, agency, veil piercing/alter ego, and estoppel.[9]

Incorporation by reference

A non-signatory is required to arbitrate with a signatory to an arbitration agreement if the non-signatory executes a contract that incorporates the arbitration agreement by reference.

The U.S. Court of Appeals for the Sixth Circuit recognized this principle in *Exch Mut Ins Co v Haskell Co*.[10] Haskell executed an agreement with Mitchell Homes that contained a clause requiring all disputes relating to the agreement to be submitted to arbitration (the "primary contract").[11] Haskell then executed a second contract with Rogersville Company by which Rogersville would assume all obligations with respect to the primary contract (the "subcontract").[12] Rogersville then obtained a performance bond through Exchange Mutual Insurance Company, conditioned on Rogersville's performing its obligations under the subcontract (the "bond").[13] The subcontract was "referred to and made part of" the bond.[14]

After a dispute arose, Haskell initiated arbitration proceedings against Exchange Mutual.[15] In response, Exchange Mutual argued that it was not a signatory to the primary contract containing the arbitration clause.[16] The Sixth Circuit held that, although Exchange Mutual was not a signatory to the primary contract, the performance bond incorporated by reference the terms of the underlying subcontract, which imposed an obligation to submit all unresolved disputes to arbitration.[17] Thus, incorporation by reference of a contract containing an arbitration provision incorporates the right and obligation to arbitrate.

Assumption

If a non-signatory's conduct indicates an intent to be bound by an arbitration award or an intent to assume the responsibilities and interests of an arbitration agreement, the non-signatory may be bound under assumption.

In *Gvozdenovic v United Air Lines*, United Air Lines contracted to hire 1,202 flight attendants from Pan American World Airways, Inc (the "incoming attendants").[18] The Association of Flight Attendants (AFA) entered into a letter of agreement with United, stating that the incoming attendants would become AFA members upon beginning employment with United. Further, the letter acknowledged that the employees' seniority status would be determined in arbitration between the incoming and incumbent flight attendants. The incoming attendants were subsequently presented offers of employment conditioned on the terms stated in the letter.[19] United then deposited $132,700 into bank accounts it had opened to assist the attendants in covering the cost of arbitration, and the incoming attendants drew from these accounts for this purpose.[20]

Dissatisfied with the arbitrator's ultimate determination, the incoming attendants sued, contending that they were neither employees of United nor members of the AFA at the time the letter was executed and thus were not bound to the arbitration award.[21] The court noted that the incoming attendants' conduct demonstrated an "active and voluntary participation in the arbitration," as the attendants chose a committee to represent them and withdrew funds from the accounts set up to cover their expenses.[22] The attendants' conduct manifested a clear intent to arbitrate the dispute, and thus they were bound by the arbitration award.[23]

Agency

Under traditional principles of agency, a principal is bound by the act of its authorized agent when the act is undertaken within the scope of the agent's authority.[24] Similarly, if a principal is bound to an arbitration agreement, its authorized agent—acting in the scope of his authority—will also be bound to arbitrate.

In *Altobelli v Hartmann*, the Michigan Supreme Court addressed whether the plaintiff's tort claims against principals of a law firm fell within the scope of an arbitration clause that mandated arbitration between the firm and a former principal.[25] Plaintiff Altobelli worked as an attorney in the law firm and upon joining the firm, the plaintiff signed an operating agreement that required arbitration of any dispute between "the firm and any current or former partner."[26] When the plaintiff's equity ownership was terminated, the plaintiff sued in state court, naming seven partners of the firm as defendants, but not the firm.[27] The defendants filed a motion for summary disposition arguing that the plaintiff's claims fell within the scope of the arbitration clause as a dispute between the firm and any current or former partner.[28]

In binding the plaintiff to the agreement, the Court considered the concept of agency, noting that "the acts of the officers and agents of a corporation, within the scope of their employment, are the acts of the corporation[.]"[29] In terminating

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the plaintiff's equity interest, the individual partners acted within the scope of their employment, and therefore, on behalf of the firm.[30] Consequently, any tort claims that the plaintiff possessed against the individual partners constituted a dispute between a former partner and the firm and therefore fell within the scope of the arbitration clause. The Court concluded that the plaintiff could not circumvent the agreement to arbitrate by naming individual officers of the firm instead of the firm itself. The order for summary disposition was therefore affirmed.[31]

Piercing the corporate veil

A non-signatory may also be bound to arbitrate when found to be the alter ego of the signatory entity, allowing the opposing party to "pierce the corporate veil."

In *Mobius Mgt Sys Inc v Technologic Software Concepts, Inc*, the petitioner, Mobius Management Systems, sought to confirm an arbitration award against Technologic Software Concepts, Inc., and its president, Thomas Politowski.[32] Mobius and Technologic had entered into an agreement under which Technologic purchased a software product from Mobius. The agreement contained an arbitration provision under which Mobius initiated an arbitration claim when Technologic failed to make payments due. In its demand, Mobius named Technologic and Politowski as jointly liable. Politowski appeared specially to contest the arbitrator's jurisdiction over him, asserting that he was not a party to the agreement and therefore could not be compelled to arbitrate. The arbitrator determined that Technologic and Politowski were jointly liable to Mobius, as Technologic was the alter ego of Politowski. Technologic appealed.[33]

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The district court recognized that

> piercing the corporate veil between a signatory and [non-signatory] party may bind the [non-signatory] party to an arbitration agreement of its alter ego. . . . [W]here an agreement include[s] a "broad provision for arbitration of all disputes arising thereunder or related thereto,". . . deciding which issues pertaining to the relationship of the parties are arbitrable should be left to the arbitrators.[34]

Mobius submitted evidence to the arbitrator that Politowski was the president and majority shareholder of Technologic, and that, upon defaulting, Technologic sold its assets and paid Politowski a portion of the proceeds.[35] Thus, the arbitrator properly concluded that the elements for piercing the corporate veil were satisfied.[36] The court held that the arbitration agreement's broad language awarded the arbitrator control over the relationships of the parties, and consequently, their liability.[37] Thus, the issue of whether Politowski was the alter ego of Technologic was properly before the arbitrator, and Politowski was legally bound by the arbitrator's decision.

Estoppel

Under the theory of estoppel, a signatory to an agreement containing an arbitration clause may be compelled to arbitrate claims against a non-signatory when the signatory relies on a term in the agreement in asserting its claims against the non-signatory.[38]

In *City of Detroit Police and Fire Retirement Sys v GSC CDO Fund Ltd*, the plaintiff entered into a consulting agreement with Smith Barney Shearson, Inc., under which the plaintiff would rely on Smith Barney to act as an investment fiduciary.[39] In the course of this relationship, Smith Barney, through its employees Murray and Giampetroni, recommended that the plaintiff invest in funds managed by GSC. Murray and Giampetroni failed to disclose that GSC operated as a private equity arm of Smith Barney. When a dispute arose, the plaintiff sued under the terms of the agreement, naming Smith Barney, Murray, and Giampetroni as defendants. The defendants then moved for summary disposition, arguing that the plaintiff was bound by an arbitration provision in the agreement.[40] The plaintiff opposed the motion on the basis that it never entered into an arbitration agreement with Murray or Giampetroni and therefore could not be compelled to arbitrate its claims against those defendants.[41]

The Court held that, under the second prong of the *Grigson* test,[42] the plaintiff was required to arbitrate all of its claims—even claims against non-signatories, as "equity does not allow a party to 'seek to hold the non-signatory liable pursuant to duties imposed by the agreement. . . but, on the other hand, deny arbitration's applicability because the defendant is a non-signatory.'"[43] The Court found that the plaintiff could not avoid arbitration of its claims against Murray and Giampetroni given that the claims were based on substantially interdependent

and concerted misconduct by all defendants. Because the plaintiff based its claims on the agreement with Smith Barney, it was estopped from avoiding applicability of the arbitration agreement, even as to non-signatories.[44]

When analyzing the scope and enforceability of an arbitration agreement, counsel should consider the policies favoring arbitration and the bias of courts to include parties and claims not expressly within the arbitration agreement when well-settled legal principals suggest a basis to include these claims within the parties' arbitration proceeding. ■

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ENDNOTES

1. *El DuPont De Nemours v Rhone Poulenc Fiber*, 269 F3d 187, 194 (CA 3, 2001).
2. *Id.* (quoting 9 USC § 4).
3. *Detroit v AVV Kutsche*, 309 Mich 700, 703; 16 NW2d 128 (1944).
4. *Amtower v William C Roney & Co*, 232 Mich App 226, 235; 590 NW2d 580 (1998).
5. *United American Healthcare Corp v Backs*, 997 F Supp 2d 741, 745–746 (ED Mich 2014) and *Beck v Park West Galleries*, 499 Mich 40, 45; 787 NW2d 804 (2016).
6. *St Clair Prosecutor v AFSCME*, 425 Mich 204, 223; 388 NW2d 231 (1986). See also *Steelworkers v Warrior & Gulf Navigation Co*, 363 US 574, 582; 80 S Ct 1347, 1353; 4 L Ed 2d 1409 (1960) ("[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'") and *Thomson-CSF, SA v American Arbitration Ass'n*, 64 F3d 773, 776, 779 (CA 2, 1995).
7. *Javitch v First Union Securities, Inc*, 315 F3d 619 (CA 6, 2003).
8. *Tobel v AXA Equitable Life Ins Co*, unpublished per curiam opinion of the Court of Appeals, issued February 21, 2012 (Docket No. 298129), pp *2–*3 and *DeCaminada v Coopers & Lybrand, LLC*, 232 Mich App 492, 502 n 7; 591 NW2d 356 (1999) ("[s]tate laws governing contracts in general do not conflict with the FAA simply because they also affect arbitration contracts.").
9. *AFSCME Council 25 v Wayne Co*, 292 Mich App 68, 81; 811 NW2d 4 (2011). The Fifth Circuit recited another commonly used list: "Six theories for binding a non-signatory to an arbitration agreement have been recognized: (a) incorporation by reference; (b) assumption; (c) agency; (d) veil-piercing/alter ego; (e) estoppel; and (f) third-party beneficiary." *Sapic v Gov't of Turkmenistan*, 345 F3d 347, 356 (CA 5, 2003).
10. *Exch Mut Ins Co v Haskell Co*, 742 F2d 274 (CA 6, 1984).
11. *Id.* at 274.
12. *Id.* at 275.
13. *Id.*
14. *Id.* at 276.
15. *Id.* at 275.
16. *Id.* at 276.
17. *Id.*
18. *Gvozdenovic v United Air Lines*, 933 F2d 1100, 1103 (CA 2, 1991).
19. *Id.*
20. *Id.* at 1104.
21. *Id.* at 1105.
22. *Id.*
23. *Id.*
24. Restatement Agency 2d § 219(1).
25. *Altobelli v Hartmann*, 499 Mich 284, 287; 884 NW2d 537 (2016).
26. *Id.* at 288.
27. *Id.* at 292.
28. *Id.* at 293.
29. *Id.* at 297.
30. *Id.* at 302.
31. *Id.* at 305–306.
32. *Mobius Mgt Sys Inc v Technologic Software Concepts, Inc*, unpublished opinion of the United States District Court for the Southern District of New York, issued September 20, 2002 (Docket No. 02 Civ. 2820(RWS)).
33. Id at *1.
34. *Id.*
35. *Id.*
36. To pierce the corporate veil, "the corporate entity must [first] be a mere instrumentality of another entity or individual. Second, the corporate entity must be used to commit a fraud or wrong. Third, there must have been an unjust loss or injury to the plaintiff." *Foodland Distributors v Al-Naimi*, 220 Mich App 453, 457; 559 NW2d 379, 381 (1996) (quoting *SCD Chemical Distributors, Inc v Medley*, 203 Mich App 374, 381; 512 NW2d 86 (1994)).
37. *Mobius*, unpub op at *2.
38. *City of Detroit Police & Fire Retirement Sys v GSC CDO Fund Ltd*, unpublished per curiam opinion of the Court of Appeals, issued May 22, 2010 (Docket No. 289185), p *6 (citing *Grigson v Creative Artists, LLC*, 210 F3d 524, 528 (CA 5, 2000)).
39. *Id.* at *1.
40. *Id.*
41. *Id.* at *4.
42. *Grigson*, 2010 F3d 524 at 528 (CA 5, 2000) (citation omitted) ("[A] non-signatory to an arbitration agreement can compel arbitration… when the signatory raises allegations of substantially interdependent or concerted misconduct by both the non-signatory and one or more signatories to the contract.").
43. *Id.* and *City of Detroit Police & Fire Retirement Sys*, unpub op at *6.
44. *City of Detroit Police & Fire Retirement Sys*, unpub op at *7.