

Litigation

**When a Nonsignatory Can Compel Arbitration
With a Signatory**

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While it is axiomatic that public policy strongly favors enforcing agreements to arbitrate, the extent to which a court will compel a signatory to an arbitration agreement to arbitrate against a nonsignatory seeking to enforce that agreement has been less certain.

Recently, however, the U.S. Court of Appeals for the Second Circuit provided some clarity on this issue. In *Sokol Holdings Inc. v. BMB Munai Inc.*,¹ the court concluded that a nonsignatory can compel arbitration under a theory of equitable estoppel only when the signatory's agreement to arbitrate can be reasonably extended to include the nonsignatory based on the relationship between the parties.

While factual intertwinement between the issues the nonsignatory seeks to arbitrate and the agreement containing the arbitration provision is required, the Second Circuit held that intertwinement by itself is not sufficient to compel arbitration. Rather, the Court made clear that foreseeability is paramount, and that the over-arching inquiry is whether the parties reasonably should have expected to arbitrate with each other.²

Applying *Sokol*, this article will address the circumstances under which a party to a contract containing an arbitration agreement may be compelled to arbitrate with a nonsignatory to that agreement.

Estoppel

Development of the Current Standard. While it is self-evident that arbitration is contractual by nature, it is less apparent that courts will sometimes require a party to arbitrate even where that party has not entered into an arbitration agreement.³

For example, courts have long recognized that a signatory to an arbitration agreement may compel a nonsignatory to arbitrate under an estoppel theory.⁴ In *Thomson-CSF*, however, the Second Circuit (citing the Fourth, Seventh, and Eleventh circuits) recognized an “alternate” estoppel theory whereby a nonsignatory to an arbitration agreement could compel arbitration with a signatory.⁵ Although declining to apply the estoppel theory to the facts before it, the *Thomson-CSF* court noted that a signatory may be estopped 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 *Sokol*, the court reviewed several of its precedents in which it had held that a party was estopped from denying its obligation to arbitrate, and clarified the circumstances under which



estoppel will apply. The court held that intertwinement between the issues the nonsignatory seeks to resolve and the agreement containing the arbitration provision is necessary to a finding of estoppel, but is not sufficient in and of itself.⁶

An obligation to arbitrate can be based only on consent, and a party cannot be required to submit to arbitration any dispute which it has not so agreed to submit, irrespective of intertwinement. That consent, however, does not necessarily require a formal contract. Rather, in the interest of fairness, consent may be inferred based on the course of dealing between the parties, when the parties should have reasonably foreseen having to arbitrate with one another.

'Sokol'

Plaintiffs in Sokol commenced an action in the U.S. District Court for the Southern District of New York, alleging that the defendants had tortiously interfered with plaintiffs' agreement to purchase a Kazak oil company by inducing the seller to breach its contract with plaintiffs and instead sell its interest to defendants. The defendants moved to stay or dismiss the action in favor of arbitration, citing an agreement between plaintiffs and the seller to arbitrate any disputes arising under the purchase and sale agreement. Although the defendants conceded that they were not parties to that agreement, they nonetheless sought to estop plaintiffs from refusing to arbitrate on the grounds that the instant dispute was "intertwined" with that agreement.

Defendants argued that the dispute was "intertwined" with the agreement between plaintiffs and seller because resolution of plaintiffs' tortious interference claim necessarily involved the question of whether the seller breached the underlying agreement. Since that agreement contained an arbitration provision, defendants argued that the arbitration provision should cover their dispute with the plaintiff. Defendants relied on *JLM Industries v. Stolt-Nielson SA*,⁷ where the Second Circuit had noted "a nonsignatory to an arbitration agreement may compel a signatory to that agreement to arbitrate a dispute where a careful review of the relationship among the parties, the contracts they signed, and the issues that had arisen among them discloses that the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed." The Sokol defendants relied on the language pertaining to intertwinement of the issues, in an effort to convince the court that it was by itself sufficient to invoke estoppel. The Second Circuit rejected defendants' argument, finding that it overemphasized the role of intertwinement, as noted above.

In addition to arguing that the intertwinement of issues supported compelling arbitration, the Sokol defendants maintained that their relationship with the seller, plaintiffs' counterparty to the arbitration agreement, mandated arbitration. Defendants noted that the counterparty had sold them his controlling block of shares in the Kazak oil company,⁸ that the company was now wholly owned by defendants, and that the counterparty was now their employee.



The Second Circuit categorically rejected defendants' argument as “a mockery of the precedents on which it relies.”⁹ The court stated that, according to plaintiffs' theory of the case, defendants only came into their “close” relationship with the counterparty by wrongfully inducing him to breach his contract. The plaintiffs had not agreed to arbitrate with defendants, and the only relationship between the parties arose through alleged tortious interference.

Although the factual issues to be resolved in the dispute may well have been intertwined with the original contract between plaintiff and its counterparty, the Second Circuit found that the facts in Sokol did not demonstrate that the plaintiffs should have reasonably foreseen arbitrating with defendants. Under those circumstances, the court held that there would be no unfairness in allowing the plaintiffs to avoid arbitrating with the nonsignatory, and thus the doctrine of equitable estoppel did not apply.

Arguing Estoppel After 'Sokol'

After Sokol, both intertwined issues and a relationship between the parties such that it is foreseeable that they would be required to arbitrate are necessary before a court will compel arbitration between a nonsignatory to an arbitration agreement and a signatory to that agreement. The Second Circuit has made it clear that the decision to compel arbitration under an estoppel theory is fact-intensive, and that earlier opinions are best characterized as describing particular circumstances in which estoppel may be found.

Nevertheless, through its discussion and analysis of relevant precedent, Sokol provides a partial blueprint for determining whether issues and relationships are such that a nonsignatory to an arbitration agreement may use estoppel to compel a signatory to arbitrate under that agreement.

Intertwinement of Issues

Intertwinement occurs when the issues the nonsignatory is seeking to resolve through arbitration are “intimately founded in” or “integrally related to” the signatory's obligations in the contract containing the arbitration clause.¹⁰ In general, intertwining may be found when the nonsignatory seeks to resolve issues that require interpretation of a contract containing an agreement to arbitrate, or that would have a direct effect on the validity of that agreement. Intertwinement will probably not be found when the nonsignatory has wrongfully interfered with a contract containing an arbitration provision, or when a nonsignatory has engaged in predatory business practices that impact a party to an agreement that includes an arbitration clause.

Thus, intertwining was present in *Choctaw Generation Ltd. Partnership v. American Home Assurance Co.*,¹¹ where a power company filed suit against a surety to a construction contract, seeking immediate funding of liquidated damages the power company was



allegedly owed under a construction contract. Although the suretyship agreement did not contain an arbitration clause, the court nonetheless allowed the surety to compel arbitration pursuant to the construction contract. The Choctaw court found that resolution of the dispute with the surety required interpretation of the construction contract, and also noted that the construction contract had been fully incorporated by reference into the suretyship agreement.

The Second Circuit again found sufficient intertwinement in *Smith/Enron Cogeneration Ltd. Partnership v. Smith Cogeneration International*,¹² where the court allowed a defendant, an original signatory that had since assigned its interest, to compel arbitration pursuant to an arbitration agreement contained in the underlying contract. The court found that the plaintiffs' claims for rescission arose under the governing contract such that it was proper to extend the obligation to arbitrate, notwithstanding the assignment of interest.

Conversely, U.S. District Judge Shira Scheindlin of the Southern District failed to find intertwinement in *Denney v. Jenkens & Gilchrist*,¹³ where plaintiffs sued a bank they claimed had conspired to promote a fraudulent tax shelter scheme. The bank sought to compel arbitration pursuant to an arbitration agreement contained in the consulting contracts into which the plaintiffs had entered with other alleged co-conspirators. The court denied arbitration, finding that the consulting contracts' terms were not central to, and thus not intertwined with, the claims against the defendants.

Relationship

In addition to finding an intertwinement of issues, the course of dealing between the parties must also evidence an implicit consent to arbitrate with one another before a signatory to an arbitration agreement will be compelled to arbitrate with a nonsignatory. This consent will be inferred where the nature of the relationship between a signatory to an arbitration agreement and a nonsignatory indicates that the agreement should be extended in the interest of fairness. The requisite relationship is typically found when a signatory deals with a counterparty comprised of multiple entities, only one of which actually signed the agreement. This is particularly true when the signatory treats affiliates or subsidiaries of the counterparty as a single entity.

Thus, in *Astra Oil Company v. Rover Navigation Ltd.*,¹⁴ a signatory who sued the parent company of its counterparty to an agreement containing an arbitration provision was ordered to arbitrate its dispute with the nonsignatory parent, based on the signatory's admission that it had negotiated the agreement with the parent and had treated the parent as a party to the contract. Similar facts warranted estoppel in JLM, where plaintiffs alleging various price-fixing claims against counterparties to shipping contracts sought to avoid their agreement to arbitrate by suing the nonsignatory parent entities. The Second Circuit held that the plaintiffs were estopped from avoiding their agreement to arbitrate, noting the plaintiffs' admission that "whatever corporate entities happened to sign the charter contracts, [plaintiffs] were purchasing shipping services directly from the parents."¹⁵

Finally, although the Sokol analysis will apply in federal cases in the Second Circuit, it may not hold up in New York state court. When the underlying contract containing the arbitration clause affects interstate commerce, the Federal Arbitration Act will be triggered and federal substantive law will apply to any disputes arising under that contract.¹⁶ Thus, the above analysis would govern. Where the FAA is not triggered, however, a nonsignatory to an arbitration agreement may have a difficult time compelling a signatory to arbitrate a dispute related to that agreement. The First Department has held that equitable estoppel is not recognized in New York as a means of allowing a nonsignatory to compel arbitration with a signatory to an arbitration agreement.¹⁷ Additionally, a mere connection between an arbitration agreement and the claims against a nonsignatory will not support extension of that agreement to include the nonsignatory.¹⁸ Generally, there must be language in the contract giving the nonsignatory the right to compel arbitration. This language should evidence a “clear, explicit, and unequivocal” agreement to arbitrate; one that does “not depend upon implication or subtlety.”¹⁹

Conclusion

Arbitration is based on consent, although in the absence of a formal agreement to arbitrate, the course of dealings between the parties may require that this consent be inferred in the name of fairness. Sokol provides a blueprint for determining when consent will be inferred between a signatory to an arbitration agreement and a nonsignatory to that agreement. A nonsignatory can compel arbitration when i) the issues the nonsignatory seeks to resolve are integrally related to the signatory's obligations under the contract containing the arbitration agreement, and ii) the relationship between the parties is such that the signatory should have reasonably foreseen having to arbitrate with the nonsignatory. Under Sokol, if both of these requirements are satisfied, the signatory's agreement to arbitrate will be extended to include the nonsignatory, and the signatory will be estopped from avoiding its agreement to arbitrate.

For further information on this topic, please contact Partner Steven R. Paradise or Associate Michael S. Davi, members of Vinson & Elkins' Securities Litigation and Enforcement Practice Group. V&E Associate Dan Centner assisted in the preparation of this article. Visit our website to learn more about Vinson & Elkins.

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- ¹ 542 F.3d 354 (2d Cir. 2008).
- ² The Second Circuit recently reiterated its holding in *Sokol* in *Ross v. Am. Express Co.*, F.3d, 2008 WL 4630314 (2d Cir. Oct. 21, 2008). *Ross* was decided on the basis of *Sokol's* holding that a signatory to an arbitration agreement will only be compelled to arbitrate with a nonsignatory when, in addition to factual intertwining, there exists “a relationship among the parties which . . . made it inequitable for [the party opposing arbitration] to refuse to arbitrate on the ground that it had made no agreement with [the nonsignatory].” *Id.* at *8 (quoting *Sokol*, 542 F.3d at 361).
- ³ *Fisser v. Int'l Bank*, 282 F.2d 231, 233 (2d Cir. 1960).
- ⁴ See, e.g., *Thomson-CSF v. Am. Arbitration Ass'n*, 64 F.3d 773, 776 (2d Cir. 1995).
- ⁵ *Thomson-CSF*, 64 F.3d at 779.
- ⁶ *Sokol*, 542 F.3d at 361.
- ⁷ 387 F.3d 163, 177 (2d Cir. 2004).
- ⁸ Recall that alleged interference with plaintiffs' contractual rights to purchase this company was the genesis of the underlying dispute giving rise to this decision.
- ⁹ *Sokol*, 542 F.3d at 362.
- ¹⁰ *Thomson-CSF*, 64 F.3d at 779.
- ¹¹ 271 F.3d 403, 406 (2d Cir. 2001).
- ¹² 198 F.3d 88, 98 (2d Cir. 1999).
- ¹³ 412 F.Supp.2d 293, 300 (S.D.N.Y. 2005).
- ¹⁴ 344 F.3d 276, 280-81 (2d Cir.2003).
- ¹⁵ *JLM Indus.*, 387 F.3d at 178.
- ¹⁶ *Conwill v. Arthur Andersen LLP*, 820 NYS2d 842, *6 (N.Y. Sup. 2006).
- ¹⁷ *Rosenbach v. Diversified Group Inc.*, 39 AD3d 271, 271 (1st Dept. 2007).
- ¹⁸ *Matter of Colonial Cooperative Ins. Co. [Muehlbauer]*, 46 AD3d 1012, 1013 (3rd Dept. 2007).
- ¹⁹ *Matter of Miller*, 40 AD3d 861, 862 (2nd Dept. 2007).