

ALTERNATIVE DISPUTE RESOLUTION

January 2010

IN THIS ISSUE

David Kash outlines strategies to protect the CEO of a company from being subject to an arbitration award when the CEO is not a signatory to the arbitration agreement, but is named in the arbitration, among other similar circumstances.

How to Protect Your CEO from Being Subject to an Arbitration Award, When Not a Party to the Arbitration Agreement

ABOUT THE AUTHOR



David W. Kash is a shareholder in the Phoenix office of Ryley Carlock & Applewhite. He received his BS with honors in Commerce (Accounting) from DePaul University in 1977 and his JD from Chicago-Kent College of Law with honors in 1981. He is admitted to practice in both Arizona and Illinois, and he is AV rated by Martindale Hubbell. In addition to being a trial attorney, he practices construction, business and commercial law. Mr. Kash is Chair of the IADC Alternative Dispute Resolution Committee and a member of the Business Litigation and Aviation Committees and a past Chair of the Surety and Fidelity Committee, a position he held for four years. He is also currently Secretary-Treasurer of The Foundation of the IADC.

ABOUT THE COMMITTEE

The Alternative Dispute Resolution Committee serves all members who use mediation and arbitration to resolve disputes, or who have become mediators or arbitrators in their own practices. The Committee publishes newsletters and is developing as a global resource for our international members, corporate counsel and insurance executives, to offer expertise when negotiating and drafting ADR provisions and on the effective use of ADR.

Learn more about the Committee at www.iadclaw.org. To contribute a newsletter article, contact:



Christopher S. Berdy
Vice Chair of Newsletters
Christian & Small, LLP
(205) 250-6635
csb@csattorneys.com

The International Association of Defense Counsel serves a distinguished, invitation-only membership of corporate and insurance defense lawyers. The IADC dedicates itself to enhancing the development of skills, professionalism and camaraderie in the practice of law in order to serve and benefit the civil justice system, the legal profession, society and our members.

While in your office, you receive a telephone referral from an out-of-state lawyer, whose corporate client wants to hire you to represent the corporation and its CEO, both have been named in an arbitration pending before a major arbitration organization in your city. You agree to take over as lead counsel.

As you review the file, you note that the CEO is not a signatory to the arbitration agreement, but is named in the arbitration. You conclude that the claimant is seeking an award personally against the head of the company. You determine that the CEO has not been served with any arbitration documentation. This paper deals with what you, as a practitioner, should do under these or similar circumstances.

The Arbitration Agreement¹

You would think that the following anti-joinder language in the arbitration agreement would be enough protection:

No arbitration arising out of or relating to this Agreement shall include, by consolidation, joinder or in any other matter, an additional person or entity not a party to this Agreement, except by written consent containing a specific reference to this Agreement signed by the Parties, and any other person or entity sought to be joined.²

¹ Maggie L. Cox, a summer associate with Ryley, Carlock & Applewhite, assisted me in the research for this paper. She is a third year law student at the University of Nebraska, an Executive Editor for the *Nebraska Law Review* and a clerk for the U.S. Attorney's Office in Omaha, Nebraska.

² *Giller v. Cafeteria of S. Beach Ltd., L.L.P.*, 967 So.2d 240, 241 (Fla.App. 2007) (holding that an architect is entitled to arbitration of his malpractice claim even

Arbitrators can be influenced by claimants armed with some published case law, who want to assert personal liability of a respondent as a means to add leverage to their claims.

Theories Used to Bind Nonsignatories to Arbitration Agreements

Despite the utilization of explicit language in an arbitration agreement, claimants have tried to bind nonsignatories to arbitration agreements. A claimant may use ordinary notions of contract and agency law in order to

though he is not named in the arbitration agreement, because the agreement defines "Architect" as the "person" lawfully licensed to practice architecture and this unambiguously included the individual); *LeNeve v. Via S. Fla., L.L.C.*, 908 So.2d 530, (Fla.App. 2005) (finding that individual having filed as a counter-petitioner, therefore waived its right to submit its claims in court); *Holly & Smith Architects, Inc. v. St. Helena Congregate Facility*, 872 So.2d 1147, 1151 (La.App. 2004) (holding that a nonparty to an arbitration agreement cannot be subject to award without evidence of written consent or rights establishing alter ego); *Int'l Bullion & Metal Brokers, Inc. v. W. Pointe Land, L.L.C.*, 846 So.2d 1276, 1277 (Fla.App. 2003) (enforcing a nonjoinder provision); *School Dist. of Philadelphia v. Livingston-Rosenwinkel, P.C.*, 690 A.2d 1321, 1322 (Pa.Cmwlth. 1997) (finding that a subcontractor could not compel arbitration when it was not a party to the contract to begin with and the contract contained a nonjoinder provision); *Ex parte Stallings & Sons, Inc.*, 670 So.2d 861, 863 (Ala. 1995) (an architect could not compel arbitration based upon the owner contractor agreement to which it was not a party and which contained anti-joinder language); *Curtis G. Testerman Co. v. Buck*, 667 A.2d 649, 654 (Md. 1995) (a corporate officer is not subject to an arbitration agreement containing an anti-joinder clause without his consent simply because he signed the agreement which mistakenly misnamed the corporation); *Donegal Mutual Ins. Co. v. Stern*, 1984 WL 2421 at **1 (Pa.Com.Pl. 1984) (an architect which signed an arbitration agreement containing an anti-joinder provision with its client, the developer, is entitled to have claims against it arbitrated, therefore the state action was stayed).

bind a nonsignatory to an arbitration award.³ So long as there is some written agreement to arbitrate, some federal courts have recognized that third parties may be bound through the following theories: 1) piercing the corporate veil or alter-ego; 2) assumption; 3) incorporation by reference; 3) agency; 4) estoppel; and 5) third-party beneficiary.⁴

Under a theory of veil piercing or alter-ego, the existence of a parent-subsidiary relationship is not enough to bind a nonsignatory to an arbitration agreement.⁵ Courts will generally look to see if the parent corporation exercised total control over the subsidiary and if the parent committed fraud through this control.⁶ If such fraud injured the party seeking to bind the nonsignatory parent to the arbitration agreement, the party has an argument to bind the nonsignatory parent to the arbitration agreement.⁷ Piercing the corporate veil theory also can expose shareholders, directors and officers if they exercise such dominion and control over the

corporation that they tout the entity as their own business and disregard corporate formalities.

Under the theory of assumption, a nonsignatory may be bound to an arbitration agreement if one can infer from his or her conduct that the nonsignatory is assuming the obligation to arbitrate.⁸ A party may also seek to bind a nonsignatory to an arbitration agreement if the party has a separate agreement with the nonsignatory which incorporates by reference the existing arbitration agreement.⁹ A claimant may seek to bind a nonsignatory to an arbitration agreement through ordinary principles of agency law.¹⁰

If a nonsignatory exploits an agreement which contains an arbitration agreement and directly benefits from that exploitation, the nonsignatory may be bound through the theory of equitable estoppel.¹¹ If a nonsignatory is an intended third-party beneficiary to an agreement containing an arbitration agreement, the nonsignatory may be compelled to arbitrate.¹² All of these theories are highly fact-intensive issues.¹³ Most federal courts recognize these theories, but vary in the way they analyze these

³ Thomson-CSF, S.A. v. Am. Arbitration Ass'n, 64 F.3d 773, 776 (2d Cir. 1995) ("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.'") (citing *McAllister Bros., Inc. v. A. & S. Transp. Co.*, 621 F.2d 519, 524 (2d Cir. 1980)); See Dwayne E. Williams, "Binding Nonsignatories to Arbitration Agreements," 25 FRANCHISE LAW JOURNAL 176-78 (2006) (discussing in detail the six theories used to bind nonsignatories to arbitration agreements).

⁴ *Comer v. Micor, Inc.*, 436 F.3d 1098, 1101 (9th Cir. 2006); *Denney v. BDO Seidman L.L.P.*, 412 F.3d 58, 71 (2d Cir. 2005); *Trippe Mfg. Co., v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005); *Bridas S.A.P.I.C. v. Gov't of Turkmenistan*, 345 F.3d 347, 356 (5th Cir. 2003); *Javitch v. First Union Securities, Inc.*, 315 F.3d 619, 628-29 (6th Cir. 2003); *Zurich Am. Ins. Co. v. Watts Indus., Inc.*, 417 F.3d 682, 687 (7th Cir. 2005); *Employers Ins. of Wausau v. Bright Metal Specialties*, 251 F.3d 1316, 1322 (11th Cir. 2001); Williams, *supra* note 2.

⁵ *Bridas S.A.P.I.C.*, 345 F.3d at 358-59.

⁶ *Id.*

⁷ *Id.*

⁸ *Thomson-CSF, S.A.*, 64 F.3d at 777.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 778.

¹² *E.I. DuPont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Intermediates, S.A.S.*, 269 F.3d 187, 195-96 (3d Cir. 2001).

¹³ *Comer v. Micor, Inc.*, 436 F.3d 1098, 1101 (9th Cir. 2006); *Denney v. BDO Seidman L.L.P.*, 412 F.3d 58, 71 (2d Cir. 2005); *Trippe Mfg. Co., v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005); *Bridas S.A.P.I.C. v. Gov't of Turkmenistan*, 345 F.3d 347, 356 (5th Cir. 2003); *Javitch v. First Union Securities, Inc.*, 315 F.3d 619, 628-29 (6th Cir. 2003); *Zurich Am. Ins. Co. v. Watts Indus., Inc.*, 417 F.3d 682, 687 (7th Cir. 2005); *Employers Ins. of Wausau v. Bright Metal Specialties*, 251 F.3d 1316, 1322 (11th Cir. 2001); Williams, *supra* note 2.

theories.¹⁴ Even though federal courts recognize these theories, the results show that courts rarely bind a nonsignatory to the arbitration agreement.¹⁵

Contract Law Should Control the Issue

“Section 2 of the Federal Arbitration Act (‘FAA’) declares that any written agreement to arbitrate contained in ‘a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or equity for the revocation of any contract.’”¹⁶ “This body of federal substantive

¹⁴ See *Comer*, 436 F.3d 1098; *Denney*, 412 F.3d 58; *Trippe Mfg. Co.*, 401 F.3d 529; *Bridas S.A.P.I.C.*, 345 F.3d 347; *Javitch v. First Union Securities, Inc.*, 315 F.3d 619; *Zurich Am. Ins. Co.*, 417 F.3d 682; *Employers Ins. of Wausau*, 251 F.3d 1316; *Williams*, *supra* note 2.

¹⁵ *Bridas S.A.P.I.C.*, 345 F.3d 347; *Merrill Lynch Inv. Managers v. Optibase, Ltd.* 337 F.3d 125 (2d Cir. 2003); *Thomson-CSF, S.A.*, 64 F.3d 773 (all holding contract and agency law theories not applicable to bind nonsignatories to arbitration agreements). *But see, Trippe Mfg. Co.*, 401 F.3d 529; *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993); *Creative Telecommunications, Inc. v. Breeden*, 120 F. Supp. 2d 1225, 1240–41 (D. Haw. 1999) (all holding contract and agency law theories applicable to bind nonsignatories to arbitration agreements); *Williams*, *supra* note 2.

¹⁶ *Williams*, *supra* note 2 at 175 (citing Section 2 of the Federal Arbitration Act). Section 2 of the Federal Arbitration Act provides:

A written provision in any maritime transaction or a contract evidencing a transaction involving interstate commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

See 9 U.S.C. § 2.

law is enforceable in both the state and federal courts,” and both the state and federal courts have continually upheld this principle.¹⁷

Arbitration is “consensual [and] a creature of contract. As such, only those who consent are bound. In the absence of any express agreement, no party may be compelled to submit to arbitration in contravention of its right to legal process.”¹⁸ Ultimately, “parties . . . are entitled to the procedures for which they bargained.”¹⁹ Only the parties to an arbitration agreement may be bound to the agreement.²⁰ The arbitration agreement is not applicable to nonparties or nonsignatories.²¹ Especially in the context of an arbitration agreement, where parties specifically agree to exclude from arbitration persons and entities who are not parties to the agreement, a nonparty is not bound to arbitrate absent the requisite consent under the agreement. The

¹⁷ *Williams*, *supra* note 2 at 175 (citing *Perry v. Thoms*, 482 U.S. 482, 489 (1987) (citing *Southland Corp. v. Keating*, 465 U.S. 1, 11–12 (1984); *Moses M. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32 (1983) (“The Arbitration Act is something of an anomaly in the field of federal-court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create an independent federal-question jurisdiction under 28 U.S.C. § 1331 (1976 ed., Supp. IV) or otherwise.)) “[T]he federal courts’ jurisdiction to enforce the Arbitration Act is concurrent with that of the state courts.” *Moses M. Cone Mem’l Hosp.*, 460 U.S. at 25.

¹⁸ *Curtis G. Testerman Co. v. Buck*, 667 A.2d 649, 654 (Md. 1995) (citing *Thomas J. Stipanowich, Arbitration and the Multiparty Dispute: The Search for Workable Solutions*, 72 IOWA L.REV. 473, 476 (1987) (citing *Martin K. Eby Constr. Co. v. City of Arvada*, 552 F. Supp. 449, 451 (D.Colo. 1981)).

¹⁹ *Donegal Mutual Ins. Co. v. Stern*, 1984 WL 2421 at **3 (Pa.Com.Pl. 1984).

²⁰ *Heinig v. Hudman*, 177 Ariz. 66, 72, 865 P.2d 110, 116 (App. 1993); *Able Distrib. Co. Inc. v. James Lampe, General Contractor*, 160 Ariz. 399, 410, 773 P.2d 504, 515 (App. 1989).

²¹ *Heinig*, 177 Ariz. at 72; *Able Distrib. Co. Inc.*, 160 Ariz. at 410.

example used above contains no exception to the prohibition, other than consent. In that sense, it should be absolute. Had a party desired to include potential nonsignatory third parties, such language should have been included in the agreement.²²

How Do You Keep a CEO from Being Bound to an Arbitration Agreement?

Who determines if a CEO, a nonsignatory to an arbitration agreement, should be bound to the arbitration agreement or a party to an arbitration award? Is this a decision for the arbitrator or for the courts to decide? This question is known as the issue of arbitrability.²³ This issue is “undeniably an issue for judicial determination.”²⁴

The Supreme Court upheld this almost 50 years ago and has reaffirmed a court’s authority on this matter several times.²⁵ “Arbitration 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.”²⁶ The Supreme Court has held that “[a] corollary of that principle is that the arbitrator only derives his or her authority to resolve the dispute because the parties have

so agreed in advance.”²⁷ Thus, there is a distinction between the authority parties to an arbitration agreement grant to an arbitrator to decide the “merits” of the dispute and the jurisdictional question of who is subject to arbitration.²⁸ “Unless the parties clearly and unmistakably provide otherwise,” the question of arbitrability is always reserved to the courts.²⁹ An arbitrator should never be given the authority to decide who is subject to the provisions of an arbitration agreement, only the judiciary has the jurisdictional authority to decide this question.

However, the Eighth Circuit has “stated that a broad arbitration clause applicable to ‘any controversy arising out of the agreement’ will vest an arbitrator with the jurisdiction to determine whether a nonsignatory is bound to arbitrate.”³⁰ Thus, you should be aware that arbitrators could claim that the scope of their authority includes determining their own jurisdiction.

A Practitioner’s Guide to Challenging the Addition of a CEO in an Arbitration Proceeding

What steps should the lawyer take to challenge the addition of his CEO to the proceedings? Do not wait for the arbitration, or to challenge the arbitration award at confirmation. Take this issue away from the arbitrator, because unless defined in the arbitration agreement, arbitrators do not have to follow or conform to the law in deciding the case. File a motion with the court, asserting that the arbitrator has exceeded his

²² Ohio Dept. of Admin. Serv. v. Design Group, Inc. 2007 WL 4171131 (Ohio App. 2007).

²³ Carpenters 46 N. Cal. Counties Conference Bd. v. Zcon Builders, 96 F.3d 410, 141(9th Cir. 1996).

²⁴ *Id.* (citing AT & T Technologies Inc. v. Communic’ns Workers of Am., 475 U.S. 643, 649 (1986)).

²⁵ Carpenters 46 N. Cal. Counties Conference Bd., 96 F.3d at 414 (citing [Steelworkers v. American Mfg. Co.](#), 363 U.S. 564 (1960); [Steelworkers v. Warrior & Gulf Navigation Co.](#), 363 U.S. 574 (1960); and [Steelworkers v. Enterprise Wheel & Car Corp.](#), 363 U.S. 593 (1960). See also *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83–84 (2002); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943–46 (1995) (upholding the judiciary’s jurisdictional authority on the question of arbitrability); Williams, *supra* note 2 at 182.

²⁶ Carpenters 46 N. Cal. Counties Conference Bd., 96 F.3d at 414 (citing *Warrior & Gulf*, 363 U.S. at 582).

²⁷ Carpenters 46 N. Cal. Counties Conference Bd., 96 F.3d at 414.

²⁸ *First Options*, 514 U.S. at 944–45; Williams, *supra* note 2 at 182.

²⁹ Carpenters 46 N. Cal. Counties Conference Bd., 96 F.3d at 414 (citing *Warrior & Gulf*, 363 U.S. at 582–83).

³⁰ *Lee v. Chica*, 983 F.2d 883, 886 n.4 (8th Cir. 1993); Williams, *supra* note 2 at 186 n.110.

or her jurisdictional authority. In this motion, the lawyer should define the distinction between the arbitrator's authority to decide the merits of the dispute and the court's jurisdictional authority to decide who is subject to arbitration. The lawyer should argue that this is a question of arbitrability and the authority to answer such question is reserved to the courts. The lawyer should address any principles of contract or agency law the party seeking to bind the CEO has asserted in compelling the CEO to the arbitration proceedings. If the CEO has not been served with a copy of the arbitration demand, the practitioner should add constitutional due process arguments to the motion. Surely, one has constitutional protections in an arbitration process.

Suggested Language to Include in Future Arbitration Agreements

What language should be employed to prevent your CEO from being forced into an arbitration proceeding or subject to an award? Here is a suggestion:

No arbitration arising out of or relating to this Agreement shall include, by consolidation, joinder or in any other matter, an additional person or entity not a party to

this Agreement, except by written consent containing a specific reference to this Agreement signed by parties, and any other person or entity sought to be joined. The parties agree that no additional person or entity shall be bound to this Agreement or to an award through any legal or equitable theories except by such written consent. The parties agree that if a disagreement should arise as to who is bound by this Agreement or subject to an award, the court has the sole jurisdictional authority to decide who is subject to this Arbitration Agreement.

Conclusion

Do not let the arbitrator decide the scope of his jurisdiction against nonparties to the arbitration agreement. If your CEO has already responded in the arbitration, you may be left with no alternative. If not, proceed to court, because there the rule of law should extricate your CEO from the arbitration proceeding.

PAST COMMITTEE NEWSLETTERS

Visit the Committee's newsletter archive online at www.iadclaw.org to read other articles published by the Committee. Prior articles include:

DECEMBER 2009 – Joint ADR and Business Litigation Committee Newsletter

5 Things You Always Wanted to Know About Arbitration: Five Issues Recently Decided by the Courts
Scott D. Marrs and Sean P. Milligan

NOVEMBER 2009

De-Construction on *Hall Street*: Circuit Courts Take a Detour on Manifest Disregard
David A. Elliot and Zachary D. Miller

JULY 2009

The Medicare, Medicaid, and Schip Extension Act of 2007: A Practitioner's Introduction to Resolution of Personal Injury Liability Claims Involving Medicare Beneficiaries
Christopher S. Berdy

MAY 2009

The Role of Mediation for ESI Disputes
Allison O. Skinner and Michael B. Maddox

JUNE 2008

Introducing the IADC's Newest Committee
David W. Kash