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Commercial division update

Binding nonsignatories to arbitration agreements

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Recent years have witnessed significant growth in the use of arbitration to resolve disputes. Viewed by many as less costly and speedier than litigation, and certainly more private, it has become the preferred route for many. With the prevalence of arbitration clauses in modern agreements, it is more important than ever for individuals and businesses to express clearly the scope of who is bound to an arbitration agreement and to understand the theories under the law for binding nonsignatories.

New York public policy encourages the enforcement of agreements to arbitrate. *See Matter of Smith Barney Shearson v. Sacharow*, **91 N.Y.2d 39, 49 (1997). Because arbitration is a matter of contract, however, "a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."** *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, **363 U.S. 574, 582 (1960). Despite this general rule and CPLR § 7501's requirement that arbitration agreements be in writing, New York has recognized that there is sometimes a "need to impute the intent to arbitrate to a nonsignatory."** *TNS Holdings v. MKI Sec. Corp.*, **92 N.Y.2d 335, 339 (1998). Courts in New York consider a well-established set of theories for determining when nonsignatories should be bound to arbitration agreements.**

Theories Binding Nonsignatories

A nonsignatory party to an agreement containing an arbitration clause may find itself bound to arbitrate based on any of five potential theories: (1) incorporation by reference; (2) assumption; (3) veil-piercing/alter ego; (4) estoppel; and (5) agency. *BGC Notes, LLC v. Gordon*, No. 651808/14 (N.Y. Co. July 13, 2015) (citing *Thomson-CSF, S.A. v. American Arbitration Ass'n*, 64 F.3d 773, 776 (2d Cir. 1995)). If a court finds any of the five theories supported by the facts of the case, a nonsignatory will be bound to the arbitration clause in question.

The first three grounds for binding nonsignatories arise less frequently. The first ground, incorporation by reference, may be found where a party to an arbitration agreement enters

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into a separate contractual agreement with a nonsignatory that incorporates the arbitration clause. As to the second ground, assumption, a nonsignatory may be bound to arbitrate where its conduct indicates that it is assuming the obligation to arbitrate, including by sending a representative to the arbitration or arguing in court that litigation is improper because the dispute must be arbitrated. *See Gvozdenovic v. United Air Lines, Inc.*, 933 F.2d 1100, 1105 (2d Cir. 1991); *In re Transrol Navegacao S.A.*, 782 F.Supp. 848, 851 (S.D.N.Y. 1991). The third ground can arise where the court pierces a corporate veil to bind a parent company to an arbitration clause of its subsidiary. *Thomson-CS*, 64 F.3d at 777.

The two remaining theories – estoppel and agency – have been relied upon in recent Commercial Division cases addressing whether a nonsignatory is bound to an arbitration clause. Both are discussed below.

Direct Benefit Estoppel Theory

"Under the direct benefits theory of estoppel, a nonsignatory may be compelled to arbitrate where it 'knowingly exploits' the benefits of an agreement containing an arbitration clause, and receives benefits flowing directly from the agreement." *Belzberg v. Versus Investments Holdings Inc.*, 21 N.Y.3d 626, 631 (2013) (citing *MAG Portfolio Consultant, GmbH v. Merlin Biomed Group LLC*, 268 F.3d 58, 61 (2d Cir 2001)). The Commercial Division has not been reluctant to find nonsignatories bound to arbitration under the theory where appropriate.

Justice Jennifer G. Schecter of the New York County Commercial Division most recently addressed the estoppel theory in *Petrides & Co. LLC v. Yorktown Partners LLC*, No. 655849/2018 (N.Y. Co. Jan. 18, 2019). Petrides had moved to compel Yorktown Partners LLC ("Yorktown"), and its related investment affiliates, to arbitrate claims under a consulting contract between Petrides and Riley Exploration Group LLC ("Riley"). Yorktown, which owned at least 90% of Riley and had majority control of its board, opposed Petrides' petition to compel arbitration on the ground that it was not a party to the contract containing the arbitration clause.

Petrides argued that the direct benefits theory of estoppel subjected Yorktown to the arbitration clause because it provided services to Yorktown under the consulting contract, which resulted in Yorktown settling a longstanding share dilution dispute. The court granted the petition, finding Yorktown bound to the arbitration provision. The court first noted that "[w]here 'the benefits are merely "indirect," a nonsignatory cannot be compelled to arbitrate a claim' . . . . 'A benefit is indirect where the nonsignatory exploits the contractual relation of the parties, but not the agreement itself.'" *Id.* at 4. It concluded that Yorktown had received a direct benefit from the agreement between Petrides and Riley. Specifically, the court held that Petrides had demonstrated that Yorktown knowingly exploited the benefits of the agreement and received the direct benefit of Petrides' work under the agreement, including that Yorktown had directed Riley to engage Petrides under the agreement to manage the settlement of the dispute. Petrides negotiated the settlement on Yorktown's behalf and Riley had no interest in the dispute but was only a "funding mechanism" for the settlement.

Justice Saliann Scarpulla of the New York County Commercial Division reached a similar result in *CF Notes, LLC v. Weinstein*, No. 652206/2015 (N.Y. Co. Oct. 13, 2016), which involved a complaint filed by CF Notes against Weinstein as to which Weinstein filed a cross-motion to compel CF Notes to arbitrate. Weinstein had entered into a six-year employment agreement with Cantor Fitzgerald, at which time he executed a "Negotiable Promissory Note and Assignment" with CF Notes, a Cantor affiliate. After Weinstein was terminated without cause, CF Notes demanded the $2 million loan amount plus interest, but Weinstein contended that CF Notes must arbitrate their claim along with Cantor per the employment agreement. The court granted Weinstein's cross-motion to compel CF Notes to arbitrate, holding that a company making a loan based on an employment agreement directly benefited from that agreement, because the ability to collect on the unforgiven portion of the loan "can be traced directly to the agreement containing the arbitration clause." *See also BGC Notes*, No. 651808/14 (nonsignatory affiliate of party to employment agreement was bound to arbitrate a loan dispute because the right to make the loan was obtained under the agreement).

Absence of Estoppel

Although the Commercial Division has shown a willingness to bind nonsignatories to arbitration when the facts dictate, a recent decision reached the opposite result. In *IQVIA RDS Inc. v. Eisai Co. Ltd*, No. 655153/2018 (Nov. 14, 2018), the dispute arose in connection with agreements involving IQVIA, Eisai and PharmaBio. PharmaBio had entered into a Collaboration Agreement with Eisai to perform clinical trials for new Esai products, which contained an arbitration clause. Six months later, PharmaBio entered into a Master Services Agreement ("MSA") with IQVIA, under which IQVIA agreed to perform subcontracted work related to clinical tests performed by PharmaBio. Eisai filed an arbitration demand against

PharmaBio pursuant to the Collaboration Agreement, but later moved to join IQVIA to the arbitration even though IQVIA was not a party to that agreement.

Justice Barry Ostrager of the New York County Commercial Division held that IQVIA was not bound by the arbitration provision and granted a stay of arbitration as to IQVIA. While PharmaBio was to receive payments from Eisai thereunder, IQVIA was compensated by PharmaBio under the separate MSA; the court held that IQVIA only received an *indirect* benefit from the agreement between PharmaBio and Eisai. Because the agreement containing the arbitration clause conferred no direct benefits to IQVIA, its stay of the arbitration was granted.

Agency Analysis

Though estoppel is the theory most often considered in deciding whether to subject a nonsignatory to an arbitration clause, recent cases have addressed the agency theory. One of the most extensive discussions of the agency theory over the past few years was by Justice Eileen Bransten of the New York County Commercial Division in *Bowery Presents LLC v. Pires*, No. 653377/2012 (N.Y. Co. June 24, 2013). That case between Bowery Presents ("Bowery"), a concert promoter, and Pires involved a dispute over paperless ticketing systems. Bowery had entered into an agreement with Ticketmaster, under which Ticketmaster was to act as Bowery's agent for the sale of tickets to entertainment events.

After purchasing a ticket through Ticketmaster, Pires brought her arbitration claims pursuant to an arbitration clause with Ticketmaster, not Bowery. She argued that Bowery should be bound to the arbitration clause because Ticketmaster had sufficient authority to bind Bowery as its agent. In ruling against Pires, Justice Bransten relied on language in the agreement between Ticketmaster and Bowery asserting that "each party is not an agent for any purpose other than as set forth in the agreement." Based on this limitation, the court concluded that Ticketmaster was only a limited agent of Bowery, protecting Bowery from Pires' arbitration demand.

The agency theory also was addressed in *Kramer Levin Naftalis & Frankel LLP v. Cornell*, No. 653381/2016 (N.Y. Co. July 14, 2016). There, Cornell had entered into an agreement with a toy company and a fund. Kramer Levin represented the toy company and fund in connection with the agreement, but was not a party to it. Cornell then alleged claims including professional malpractice, breach of fiduciary duties, and negligent misrepresentation, and sought an order to compel Kramer Levin to arbitrate those claims on the basis that it acted as counsel to the toy company and fund. Justice Anil C. Singh permanently stayed the arbitration as to Kramer Levin, given the firm's status as a nonsignatory and the absence of an agency relationship. The court principally relied on the fact that Cornell agreed in the agreement that Kramer Levin was not an agent, and Kramer Levin's clients never authorized it to commit the malpractice wrongs alleged and thus would be outside of the alleged agency.

Conclusion

As these recent cases show, the Commercial Division recognizes that circumstances may require binding nonsignatories to arbitration agreements. The direct benefit theory of estoppel and agency are is the most frequent reason that demands for arbitration are granted against nonsignatories. Individuals and businesses would do well to be mindful of these theories when interacting with business partners and affiliates lest they find themselves in an unexpected arbitration.

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