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Three's Company: Can a Nonsignatory to an Arbitration Agreement Compel or Be Compelled to Arbitrate?

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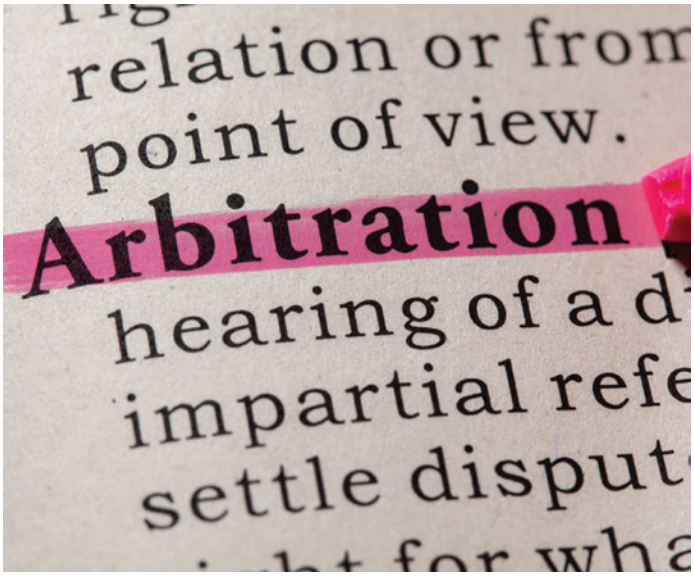
The proliferation of arbitration agreements in consumer and business contracts presents challenges when a dispute, governed by an arbitration agreement, also involves claims against or advanced by a third party, who is not party to that arbitration agreement. Indeed, the Federal Arbitration Act enforces an arbitration agreement notwithstanding the presence of others who are parties to the underlying dispute but not the arbitration agreement. New Jersey's public policy applies similar tenets when reviewing matters governed by its Arbitration Act, noting N.J.S.A. 2A:23B-6, provides an agreement to arbitrate is "valid, enforceable, and irrevocable except upon a ground that exists at law or in equity for the revocation of a contract."

Consequently, courts often stay disposition of claims of nonsignatories pending the arbitration outcome, which not only increases costs—based on the need to litigate on two fronts—but also, extends ultimate finalization of disputes. Any comprehensive litigation plan must understand when and whether a third-party nonsignatory to an arbitration agreement may be compelled to join an arbitral disposition of disputes or, correspondingly, when a nonsignatory might be the driving force to require arbitration.

It is well-settled that arbitration is a matter of contract. Courts in New Jersey, much like federal



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courts, emphasize strong public policy favoring arbitration to resolve disputes and require liberality in construing contracts in favor of arbitration. While public policy favors arbitration, it is just as important that arbitration agreements be the product of mutual assent because "an agreement to arbitrate involves a waiver of a party's right to have [their] claims and defenses litigated in court." *Atalese v. U.S. Legal Servs. Grp.*, 219 N.J. 430, 442 (2014). Bound to follow contract terms, courts may not rewrite an agreement to broaden the scope of arbitration. Judges remain reluctant to compel a nonsignatory to arbitrate in the absence of expressed mutual consent, necessitating an enti-

tlement to invoke arbitration and a valid, binding arbitration agreement.

So, when can a party, who agreed to arbitrate compel a third-party nonsignatory to participate in the arbitration proceeding and be bound by the issued award? And, do concerns arise if a third party moves to compel arbitration under an agreement they did not sign?

Federal and state courts bind nonsignatories to arbitration agreements when "traditional principles of state law allow a contract to be enforced by or against nonparties to the contract." *Arthur Andersen v. Carlisle*, 556 U.S. 624, 631 (2009). Consequently, various legal theories employed by or against nonsignatories may compel arbitration, including, equitable estoppel, third-party beneficiaries, agency, assignment, alter ego or veil piercing, and incorporation by reference.

Equitable estoppel seeks "to prevent injustice by not permitting a party to repudiate a course of action on which another party has relied to his detriment." *Hirsch v. Amper Fin. Servs.,* 215 N.J. 174, 179–80 (2013). Equitable estoppel focuses on a party's actions or inactions, and, as noted in *Hirsch*, is "viewed more properly as a shield to prevent injustice rather than a sword to compel arbitration."

Federal courts apply two theories of equitable estoppel to bind a nonsignatory to an arbitration clause. First, nonsignatories are bound to arbitration when they knowingly exploit the underlying agreement containing an arbitration provision despite never signing the agreement. Second, a signatory is bound to arbitrate with a nonsignatory when there is a "close relationship between the entities involved as well as the relationship of the alleged wrongs to the nonsignatory's obligations and duties in the contract … and [that] the claims were intimately founded in and intertwined with the underlying contract obligations." *E.I. DuPont de Nemours v. Rhone Poulenc Fiber & Resin Intermediates*, 269 F.3d 187, 199-200 (3d Cir. 2001).

New Jersey courts more cautiously use equitable estoppel to compel arbitration, remaining steadfast to the principal arbitration is subject to mutual assent. Indeed, the New Jersey Supreme Court in *Hirsch* rejected "intertwinement" of parties and claims as a theory for compelling arbitration "when its application is untethered to any written arbitration clause between the parties." The court explained there must be additional evidence of detrimental reliance or "at a minimum an oral agreement to submit to arbitration."

Similarly, whether seeking to avoid or compel arbitration, a third party may be bound by contract terms for a claim arising out of the underlying contract to which it is an intended third-party beneficiary. *Crystal Point Condo. Ass'n v. Kinsale Ins.,* 251 N.J. 437, 455 (2022); *Seborowski v. Pittsburgh Press Company,* 188 F.3d 163, 168 (3d Cir. 1999). When applied, courts find the contract terms confer to another the benefit of rights, remedies and redress as afforded to the parties to the contract. "The principle that determines the existence of a third party beneficiary status focuses on whether the parties to the contract intended others to benefit from the existence of the contract, or whether the benefit so derived arises merely as an unintended incident of the agreement." *Hojnowski ex rel. Hojnowski v. Vans Skate Park*, 375 N.J. Super. 568, 576 (App. Div. 2005), aff'd sub nom. *Hojnowski v. Vans Skate Park,* 187 N.J. 323 (2006). This includes intended successors to a signatory's interest.

Nonsignatories may compel or be compelled to arbitrate liability when the nonparty is an agent of a contracting party. *Pritzker v. Merrill Lynch, Pierce, Fenner & Smith,* 7 F.3d 1110, 1121-22 (3rd Cir.1993); *Bruno v. Mark MaGrann Assocs.,* 388 N.J. Super. 539, 547 (App. Div. 2006). The mere existence of a corporate connection is insufficient to bind a related, nonsignatory company to an arbitration clause. Rather it is necessary to show an agency arrangement and that the arrangement relates to the matter in dispute.

Importantly, direct control over an agent by the principal is not necessary to establish an agency relationship. In fact, a principal can have "control even if the principal has previously agreed with the agent that the principal will not give interim instructions to the agent or will not otherwise interfere in

the agent's exercise of discretion." Restatement (Third) Agency, Section 101 cmt. f(1). Thus, when one corporation acts as the agent of a disclosed principal corporation, the latter corporation may be liable on contracts made by its agent.

An assignee, although not a party to the arbitration contract, may also enforce arbitration clauses executed by its assignor. "[A]n assignment needs no particular form and requires only so much of a description of the intangible assigned to make it readily identifiable." *New Century Fin. Servs. v. Oughla*, 437 N.J. Super. 299, 319 (App. Div. 2014). Vehicle leases often include assignment clauses. As noted in *New Century,* the essential element for enforcement is the assignor's intent "gleaned from the documents themselves and surrounding circumstances." Thus, the assignee steps into the shoes of the original signatory assignor, allowing the assignee to compel arbitration when the assignment is "free and clear of ambiguity" as to the assignee, and is otherwise found to be valid.

The tenets of alter ego and veil piercing collapse the differentiation of two parties, treating them as one, which could legally compel enforcement of an agreement for arbitral disposition of disputes or satisfaction of an arbitration award—meaning an arbitration award against one entity could bind another. Thus, an individual may be liable for corporate obligations as the alter ego when they abused the corporate form in order to advance personal interests. The equitable remedy of veil piercing applies to disregard the corporate entity and hold individual principals liable for corporate debts. Generally, courts will not pierce the corporate veil absent fraud or injustice.

When a dispute involves two different but related contracts, only one of which has an arbitration provision, incorporation by reference arguments have successfully pushed parties to proceed in arbitration. *Field Intelligence v. Xylem Dewatering Solutions*, 49 F.4th 351 (3rd Cir. 2022).

When a party enters into a separate contractual relationship with a nonsignatory that refers to another agreement with an arbitration clause, the nonsignatory may compel arbitration. This could involve a subsequent agreement that modifies portions of the original agreement but leaves unmodified provisions in effect—essentially combining the terms of one agreement with another.

To have a proper and enforceable incorporation by reference of a separate document, (1) the incorporated document "must be described in such terms that its identity may be ascertained beyond doubt" and (2) "the party to be bound by the terms must have had knowledge of and assented to the incorporated terms." *Alpert, Goldberg, Butler, Norton & Weiss v. Quinn,* 410 N.J. Super. 510, 533 (App. Div. 2009).

Finally, parties can always consent to proceed in arbitration even in the absence of a written agreement. That decision implicates practical determinations. Clients must evaluate whether benefits accompanying arbitration outweigh specific protections and formalities of resolving disputes in a judicial forum.

In an arbitral setting, discovery may be limited and expedited, which could have a significant impact in proving claims or establishing defenses. On the other hand, parties choose their arbitrator and the process may be a less expensive option when expedited.

Additionally, arbitration offers something a judicial forum cannot—confidentiality and privacy in resolving disputes, which may be a more desirable option for a client depending on the nature of the claims at issue.

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