Vanderbilt Law Review

Volume 60 | Issue 2 Article 14

3-2007

Equitable Estoppel and the Compulsion of Arbitration

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Alexandra A. Hui, Equitable Estoppel and the Compulsion of Arbitration, 60 *Vanderbilt Law Review* 711 (2019)
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Equitable Estoppel and tbe Compulsion of Arbitration

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I. INTRODUCTION

Freedom of contract is a longstanding principle deeply rooted in American jurisprudence, protected by the Contract Clause and by

the Due Process Clauses of the Fifth and Fourteenth Amendments.[1] Because of the legal system's high regard for freedom of contract, parties are free to negotiate virtually all issues, thus creating rights and limiting duties and obligations to one another.

In exercising this freedom to contract, parties often negotiate an arbitration clause. These clauses, also referred to as "predispute arbitration agreements," are contractual provisions agreed to in advance of any dispute that require a party to submit any and all future disputes to arbitration.[2] The American Arbitration Association's standard arbitration clause, for example, places the following obligations on the signatories:

> Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association in accordance with its [applicable] rules and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof.[3]

Despite the promise to arbitrate, oftentimes one party will circumvent an arbitration agreement and turn to the traditional dispute resolution mechanism: litigation. In these situations, the defendant typically brings the arbitration clause to the court's attention, asking the court to compel the plaintiff to arbitrate.

Upon being asked to enforce an arbitration agreement, the court decides whether it is valid to compel the parties to arbitrate. First, the court must determine whether there is an agreement to arbitrate. The court must undertake this task first because "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."[4] The gateway question of arbitrability (whether there is a valid arbitration agreement) is "undeniably an issue for judicial determination."[5] Courts, not arbitrators, therefore scrutinize

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1. U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts); U.S. CONST. amend. V, XIV; 16B AM. JUR. 2D *Constitutional Law* §§ 568, 594 (2006).

2. F. PAUL BLAND, JR. ET AL., CONSUMER ARBITRATION AGREEMENTS: ENFORCEABILITY AND OTHER TOPICS 2 (2d ed. 2002).

3. AMERICAN ARBITRATION ASSOCIATION, DRAFTING DISPUTE RESOLUTION CLAUSES – A PRACTICAL GUIDE 5 (1993).

4. Intergen N.V. v. Grina, 344 F.3d 134, 142 (1st Cir. 2003) (quoting AT&T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 648 (1986)).

5. *AT&T Techs.*, 475 U.S. at 649. The authority stems from the fact that "arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration." *Id.* at 648-49. Parties can, however, agree to submit the arbitrability question itself to the arbitrator. *See* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943 (1995). In such a case, a court must defer to the arbitrator's arbitrability decision. *Id.* This is a rare circumstance, however: "[C]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is *'clear and unmistakable'* evidence that they did so." *Id.* at 944 (quoting *AT&T Techs.*, 475 U.S. at 649) (emphasis added).

arbitration clauses to determine whether the parties intended to agree to arbitration, which can be evidenced by signature to the contract. Though a signed arbitration agreement is "the customary implementation of an agreement to arbitrate,"[6] courts recognize that there are situations in which "a party may be bound by an agreement to arbitrate even in the absence of a signature."[7] In certain disputes arising between a signatory to a contract and a nonsignatory, a court may rule that the arbitration clause binds even the nonsignatory to arbitrate the dispute. In determining whether the nonsignatory manifested the requisite intent to arbitrate, courts are "limited only by generally operative principles of contract law."[8]

The particular situations in which a court could compel a nonsignatory to arbitrate were first synthesized and articulated in *Fisser v. International Bank.*[9] In *Fisser*, the Second Circuit listed five principles on which courts had traditionally bound the nonsignatory to the arbitration clause: (1) assignment of the contract; (2) exercising an option creating a mutually binding contract to arbitrate; (3) addition of a party through novation; (4) agency considerations in which the nonsignatory is "merely the instrumentality of a party bound by the arbitration clause;" and (5) enforcement by a corporate beneficiary of an arbitration provision while it was inchoate.[10] In addition to these five categories, the court articulated a new, sixth category, which formed the basis for its judgment: the alter ego theory.[11] Under this theory, if the nonsignatory is merely the signatory's alter ego, it is "a proper case to pierce the corporate veil . . . and to hold those controlling it as one with it."[12] This alter ego nonsignatory would be obligated to specifically perform the signatory's other contractual obligations, including arbitration.[13]

Over the years, courts have grouped these concepts into the following five categories: (1) incorporation by reference, (2) assumption, (3) agency, (4) veil-piercing/alter ego, and (5) equitable estoppel.[14] While the first four factors are firmly grounded in contract and agency principles, courts have pushed the equitable estoppel

6. Sarhank Group v. Oracle Corp., 404 F.3d 657, 662 (2d Cir. 2005).

7. McAllister Bros., Inc. v. A & S Transp. Co., 621 F.2d 519, 524 (2d Cir. 1980).

8. Fisser v. Int'l Bank, 282 F.2d 231, 233 (2d Cir. 1960).

9. *Id.*

10. *Id.* at 233 n.6.

11. *Id.* at 234.

12. *Id.*

13. *Id.* at 234-35.

14. *See, e.g.*, Thomson-CSF, S.A. v. Am. Arbitration Ass'n, 64 F.3d 773, 776 (2d Cir. 1995) (discussing each of the five factors and holding that the plaintiff could not be compelled to arbitration).

factor to its outer bounds—so far that it is invalid under general contract principles.

Courts have developed the principle of equitable estoppel in two distinct applications. Traditionally, the principle of equitable estoppel was used to compel a nonsignatory to arbitrate because the nonsignatory had previously claimed that other provisions of the contract should be enforced to benefit him. This is the "first strand" of equitable estoppel and is a proper theory by which the courts can compel arbitration.[15] Courts, however, have created new applications of equitable estoppel, allowing a *nonsignatory* defendant to compel the *signatory* to arbitrate. This is the "second strand" of equitable estoppel. In *MS Dealer Service Corp. v. Franklin*,[16] for example, the Eleventh Circuit articulated two particular applications of the second strand of equitable estoppel: (1) when the signatory to a written agreement containing an arbitration clause relied on the written agreement's terms in asserting its claims against the nonsignatory, or (2) when the signatory raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory and one of the signatories to the contract.[17] Thus, under the second strand of equitable estoppel, a close relationship between the signatory and the nonsignatory may suffice to compel an unwilling signatory to arbitrate with the nonsignatory,[18] even though this is not a contractual relationship.

As this Note argues, however, the application of the second strand of equitable estoppel is invalid. Certain relationships are so attenuated as to be outside of the realm of contract and thus insufficient to compel arbitration. Courts, however, routinely apply the doctrine of equitable estoppel in this manner. This not only disregards the most fundamental principle of arbitration—that a party may only be compelled to arbitrate when he previously agreed to arbitration—but it also discourages careful drafting of contracts, and indeed may discourage parties from creating a written document altogether. Furthermore, it improperly gives a nonsignatory the power to compel arbitration according to the contract when he has no contractual relationship to the signatory.

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15. Some courts also refer to this as "direct-benefit" estoppel. *See, e.g.*, Hellenic Inv. Fund, Inc. v. Det Norske Veritas, 464 F.3d 514, 517 (5th Cir. 2006). For the sake of comparing and contrasting the types of estoppel, however, I will refer to "direct-benefit" estoppel as the first strand of equitable estoppel.

16. MS Dealer Serv. Corp. v. Franklin, 177 F.3d 942 (11th Cir. 1999).

17. *Id.* at 947; *accord* Grigson v. Creative Artists Agency, 210 F.3d 524, 527 (5th Cir. 2000).

18. *See, e.g.*, Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc., 10 F.3d 753 (11th Cir. 1993); McBro Planning & Dev. Co. v. Triangle Elec. Constr. Co., 741 F.2d 342 (11th Cir. 1984).

This Note will argue that to effectuate parties' objectively manifested intent, the American judicial system should restructure the doctrine of equitable estoppel, eliminating the applications that allow a willing *nonsignatory* to compel an unwilling *signatory* to arbitrate. This does not altogether eliminate equitable estoppel, but rather ensures that the doctrine is only used where there is truly a contractual agreement to arbitrate, the fundamental requisite for compelling arbitration. Furthermore, this guarantees that only parties entitled to invoke the arbitration clause may do so, thereby redirecting the focus and application of equitable estoppel to compelling the nonsignatory, not the signatory, to arbitrate.

In making this argument, Part II will briefly discuss how arbitration became an alternative to a judicial proceeding in the United States' courts, why arbitration is often an attractive option, and how the Federal Arbitration Act allocates issues between the arbitrator and the courts. Part III will analyze more specifically the current principles, excluding equitable estoppel, that courts are using to determine when a nonsignatory may be compelled to arbitrate. These four principles, as this Note will argue, are properly grounded in contract and agency law and are a valid means for compelling a nonsignatory to arbitrate. Part IV will then focus on the principle of equitable estoppel, undertaking a detailed analysis of both strands. In so doing, this Note will argue that courts invalidly use the second strand of equitable estoppel to compel a signatory to arbitrate with a nonsignatory against the signatory's will. This is not a valid contract or agency principle and therefore directly subverts the Federal Arbitration Act on its face. Part V will then propose eliminating the strand of equitable estoppel used to compel an unwilling signatory plaintiff to arbitrate with a willing nonsignatory. Doing so would result in a more streamlined and tailored standard that will require a contractual agreement to arbitrate, thereby realigning the analysis with the requirements of the Federal Arbitration Act and accompanying case law.

II. BACKGROUND: ARBITRATION IN AMERICA AND THE FEDERAL ARBITRATION ACT

A. Background and Scope

The Federal Arbitration Act ("FAA")[19] was enacted in 1925 without opposition.[20] The lack of opposition resulted from the

19. 9 U.S.C. §§ 1-14, 201-208 (2006).

universal understanding that the statute was intended to be procedural in nature and applicable only in federal courts.[21] However, the landmark case *Erie Railroad Co. v. Tompkins*[22] ultimately transformed the FAA into a substantive, national regulatory statute.[23] Because the constitutional foundation of the FAA has now shifted from congressional power to control federal courts to congressional power to regulate commerce,[24] the FAA supersedes state law under the Supremacy Clause of the United States Constitution and is applicable in both state and federal court.[25]

The FAA is limited to the subject matter over which the federal government unquestionably has substantive constitutional power: commerce and maritime matters.[26] Section 3 stays litigation pending arbitration,[27] while § 4 is the all-important mechanism whereby courts can compel parties "to proceed to arbitration in accordance with the terms of the agreement."[28]

Various other sections supplement the implementation of these basic principles of full enforceability by providing for judicial appointment of arbitrators, conferring power on the arbitrators to summon witnesses, and granting courts the power to issue orders confirming awards.[29] The statute also contains regulatory provisions, which specify grounds for vacating and modifying arbitration awards.[30] Ultimately, the FAA is an "unquestionably integrated, unitary statute, consisting of core provisions and provisions supplementing them."[31]

The most important provision in the FAA, however, is § 2, which establishes a presumption in favor of arbitration: Contracts

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20. IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION 115 (1992).

21. *Id.* at 83, 109-20.

22. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).

23. MACNEIL, *supra* note 20, at 135.

24. In *Prima Paint Corp. v. Flood & Conkling Manufacturing Co.*, the Supreme Court held that congressional authority to prescribe the federal courts' authority over arbitration agreements is under the Commerce Clause. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 405 (1967) (quoting legislative history).

25. *See, e.g.*, Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 126 S. Ct. 1204, 1209 (2006); Southland Corp. v. Keating, 465 U.S. 1, 12 (1984); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25-26 n.34 (1983); MACNEIL, *supra* note 20, at 149. For a more complete discussion on how *Erie* ultimately transformed the FAA, see MACNEIL, *id.* at 134-55.

26. *See* 9 U.S.C. §§ 1-2 (2006).

27. 9 U.S.C. § 3.

28. 9 U.S.C. § 4.

29. MACNEIL, *supra* note 20, at 103.

30. *Id.* at 104.

31. *Id.* at 105-06.

including an arbitration clause "shall be valid, irrevocable, and enforceable" unless a court finds that they must be invalidated per typical "grounds as exist at law or in equity for the revocation of any contract."[32] Thus, courts use traditional contract principles to determine whether an arbitration clause is enforceable. As will be discussed below, courts often extend these principles to nonsignatories to the contract.

B. Why Arbitration Is an Attractive Option

The FAA fueled the growth of arbitration in the United States, providing an attractive alternative to the traditional litigation proceeding. The American Arbitration Association ("AAA"), founded in 1926, has thirty-five offices in the United States and Ireland and employs over 8000 arbitrators and mediators.[33] In 2004, the AAA heard over 159,000 cases.[34] Arbitration clauses are now standard in most commercial contracts.

Commercial parties find arbitration attractive for several reasons. Perhaps the main reason corporations want to arbitrate is the effective limitation of exposure to large damage awards, including a dramatic reduction in punitive damage awards, because arbitrators tend to impose smaller amounts.[35] Arbitration is also geared to result in "the final disposition of differences between parties in a faster, less expensive, more expeditious, and perhaps less formal manner than is available in ordinary court proceedings."[36] Likewise, arbitration is attractive because the parties have the mutual capacity to select the arbitrator, who most likely will bring specialized expertise to the proceeding that the typical judge and lay jury cannot.[37] Corporations also prefer arbitration for strategic reasons. An arbitrator is neither publicly chosen nor publicly accountable.[38] Furthermore, in most commercial cases the arbitrator is not required to give a reasoned explanation of the result, and arbitrators commonly provide no written explanation for their decisions.[39] In general, an arbitrator

32. 9 U.S.C. § 2.

33. American Arbitration Association, Fast Facts, http://www.adr.org/sp.asp?id=26078.

34. *Id.*

35. 4 AM. JUR. 2D *Alternative Dispu6te Resolution* §§ 3, 7 (2006).

36. 4 AM. JUR. 2D *Alternative Dispute Resolution* § 8 (2006).

37. *Id.* It would, however, "appear sufficient that the arbitrators have at least a generalized knowledge of the field. . . ." LARRY E. EDMONSON, 1 DOMKE ON DISPUTE RESOLUTION § 25:2 (3d ed. 2006).

38. *Id.*

39. *Id.* §§ 177, 180. Courts do not have jurisdiction to set aside arbitration awards unless one of two conditions is met: either it is stipulated that the arbitrators should follow legal rules of procedure, *id.* § 177, or a statute applicable to the case prescribes rules, *id.* §§ 177, 180. Some

need not follow the rules of procedure and evidence.[40] The scope of discovery is within the arbitrator's discretion and often is extremely limited: though arbitrators are not precluded from ordering discovery, parties agreeing to arbitrate their claims generally relinquish their right to pretrial discovery or to subpoena documents (absent extreme circumstances).[41] Limiting discovery in this manner can lead to a great reduction in costs. Finally, because of the FAA's restriction on the ability to appeal an erroneous interpretation of the law, arbitrators can effectively ignore statutes and judicial precedent.[42]

These potential benefits, however, may also be seen as drawbacks because they compromise procedural protections available in court. Indeed, any of the aforementioned strategic reasons to proceed in an arbitral forum may be seen as a disadvantage to a party who prefers the procedural safeguards of traditional litigation. For example, the capacity to select the arbitrator may lead to a bias in favor of repeat players, in part because many arbitrators compete to

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commentators have noted that there are two schools of thought regarding evidentiary standards. One school of thought views arbitration as primarily a private mechanism and thus believes the arbitrator is not bound by evidentiary rules. In contrast, the opposing school of thought believes that the arbitrator is nevertheless bound to the Code of Professional Responsibility, which requires the arbitrator to provide a fair and adequate hearing with opportunities to present their respective evidence and argument. MARVIN F. HILL, JR. & ANTHONY V. SINICROPI, EVIDENCE IN ARBITRATION 3-4 (2d ed. 1989). Even so, the latter school of thought recognizes that arbitrators are not *bound* by evidentiary rules, even if they do adopt them as a prudential matter. *Id.* at 4.

40. 4 AM. JUR. 2D *Alternative Dispute Resolution* § 177 (2006); EDMONSON, *supra* note 36, § 1:1. Arbitrators may still order discovery to "preserve notions of fairness and to comport with a party's due process rights." 4 AM. JUR. 2D *Alternative Dispute Resolution* § 187; *see* 9 U.S.C. § 7 (2006).

41. 4 AM. JUR. 2D *Alternative Dispute Resolution* § 6 (2006).

42. *See id.* § 180 ("[U]nless it is stipulated that the arbitrators should follow legal rules of procedure, the courts have no jurisdiction to set aside an award for failure of the arbitrators to follow court rules."); EDMONSON, *supra* note 36, § 1.1 ("Arbitration tribunals are not generally required to apply principles of substantive law.... Unless so required by parties, arbitrators give no reason for their decision, and the award is generally not open to review by courts for any error in finding facts and applying law."). This is not to say, however, that a court can never vacate an award. A federal court may vacate an award

> (1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10 (2006). The same avenue for appeal does not exist, however, for mere mistakes as to law or fact.

be selected by the parties to arbitrations.[43] If arbitrators rule against these corporations too frequently, they risk losing their business.[44] Parties aware of this bias may choose to exploit it in their favor. Despite these drawbacks, however, arbitration is gaining in popularity, and many parties agree ex ante to arbitrate any and all future claims that may arise between them.

C. How the Statute Operates

In addition to articulating when a claim is arbitrable and establishing a policy in favor of arbitrability,[45] the FAA "set[s] out a comprehensive integrated modern arbitration law containing everything needed for a complete system of arbitration, other than the basic contract law necessarily underlying any such system."[46] The federal statute may implement the system governing arbitration once an agreement to arbitrate has been established, but the initial question of whether agreement exists is a matter of common law contract principles. Because arbitration is contingent on this agreement, "a party who has not agreed to arbitrate will normally have a right to a *court's* decision about the merits of its dispute."[47] The gateway question of arbitrability (whether there was an agreement to arbitrate) is generally for the courts to determine.[48] This agreement to arbitrate is explicitly evidenced when both parties are signatories to a contract containing an arbitration clause. But when the dispute over arbitrability involves a nonsignatory to the contract, the matter becomes far more complicated. The mere fact that one of the parties did not sign the contract containing the arbitration clause does not foreclose the possibility of arbitration. Because arbitration is a "creature of contract law," courts asked to compel a nonsignatory to arbitrate under an arbitration agreement analyze whether the

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43. BLAND ET AL., *supra* note 2, at 4.

44. *Id.*

45. *See* 9 U.S.C. § 2 (establishing the validity of an arbitration clause "save upon such grounds as exist at law or in equity").

46. MACNEIL, *supra* note 20, at 102.

47. First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 942 (1995) (emphasis added); *see supra* note 5 and accompanying text. Questions as to the validity of tbe contract as a whole, and not specifically the arbitration provisions, are to be considered by an arbitrator. Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 126 S.Ct. 1204, 1209 (2006). Arbitration clauses, however, are severable from tbe remainder of the contract, and challenges as to the validity of arbitration clauses are to be heard by courts. *Id.* This Note only addresses the question of whether an agreement to arbitrate exists, not whether the contract as a whole is valid.

48. AT&T Techs., Inc. v. Commc'ns. Workers of Am., 475 U.S. 643, 649 (1986).

nonsignatory is bound under traditional contract and agency principles.[49]

III. ANALYSIS: THE FOUR LEGITIMATE PRINCIPLES USED TO COMPEL NONSIGNATORIES TO ARBITRATE

Because the question of arbitrability is a matter of contract, arbitrability "is undeniably an issue for judicial determination . . . to be decided by the court, not the arbitrator."[50] The circuit courts of appeals review *de novo* the decisions of the district courts regarding arbitrability,[51] analyzing the claim using a five-part framework that consists of "theories aris[ing] out of common law principles of contract and agency law"[52] applicable in the arbitration context. There are five general contract and agency principles by which a court may bind nonsignatories to arbitration: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter ego; and (5) estoppel.[53]

Estoppel typically entails equitable estoppel, which "precludes a party from enjoying rights and benefits under a contract while at the same time avoiding its burdens and obligations."[54] Traditionally, this doctrine was used to estop nonsignatories from asserting that their lack of signature on the contract precluded enforcement of the arbitration clause while simultaneously claiming rights and benefits under the contract.[55] Via the application of the second strand, however, the equitable estoppel doctrine is used to estop *signatories*, rather than nonsignatories. "Willing" nonsignatories (defendants in a suit who file motions to compel arbitration) may compel "unwilling" signatories (the plaintiffs against whom the motions are filed) to

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49. E.I. Dupont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Intermediates, S.A.S., 269 F.3d 187, 194-95 (3d Cir. 2001).

50. *AT&T Techs.*, 475 U.S. at 649.

51. *See, e.g.*, Bouriez v. Carnegie Mellon Univ., 359 F.3d 292, 294 (3d Cir. 2004) ("We exercise plenary review over the District Court's order compelling arbitration."); Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc., 10 F.3d 753, 756 (11th Cir. 1993) ("We review *de novo* the district court's order compelling arbitration."). *But see* Grigson v. Creative Artists Agency, L.L.C., 210 F.3d 524, 528 (5th Cir. 2000) ("Accordingly, whether to utilize equitable estoppel in this fashion is within the district court's discretion; we review to determine only whether it has been abused."); Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH, 206 F.3d 411, 416 (4th Cir. 2000) ("We review factual findings that form the basis of a decision as to whether the parties have agreed to submit a dispute to arbitration for clear error."). Because the application of contract law principles to determine arbitrability is a question of law and not of fact, the proper standard for review is de novo.

52. Thomson-CSF, S.A. v. Am. Arbitration Ass'n, 64 F.3d 773, 776 (2d Cir. 1995).

53. *See, e.g.*, Hellenic Inv. Fund, Inc. v. Det Norske Veritas, Inc., 464 F.3d 514, 517 (5th Cir. 2006); *Thomson-CSF*, 64 F.3d at 776.

54. Intergen N.V. v. Grina, 344 F.3d 134, 145 (1st Cir. 2003).

55. *Int'l Paper*, 206 F.3d at 417-18.

arbitrate their dispute. As this Note argues below, this is an invalid basis for compelling arbitration, as it does not follow traditional contract principles.

To illustrate why the second strand of equitable estoppel does not fit within traditional contract principles, it is helpful to understand first why the other methods are valid under these principles. The following Sections will explain the various contract and agency principles used both to bind a nonsignatory to arbitration and, in the case of equitable estoppel, to bind a signatory to arbitrate with a nonsignatory against the signatory's will.

A. Incorporation by Reference

Under the incorporation by reference theory, a signatory to a preexisting contract may compel arbitration against a nonsignatory when the two parties entered into a new contract that incorporated the first contract by reference. Furthermore, "[a] nonsignatory may compel arbitration against a party to an arbitration agreement when that party has entered into a separate contractual relationship with the nonsignatory which incorporates the existing arbitration clause."[56] This theory, though it allows a nonsignatory to compel a signatory, is consistent with the requirement of an agreement to arbitrate because parties who were not privy to the first contract effectively become signatories thereto by incorporating the preexisting contract into their new contract. To better illustrate why incorporation by reference is valid, let us imagine a situation between two parties in which the parties incorporate a preexisting contract containing an arbitration clause into a newly negotiated contract. For example, imagine a situation in which two parties, A and B, negotiated a contract containing an arbitration clause. Party B then negotiates a new contract with Party C, incorporating the preexisting contract by reference. One can call the prior contract "Contract 1" and the second contract incorporating the prior contract by reference "Contract 2." When Contract 1 is incorporated by reference into Contract 2, Contract 1's arbitration clause becomes part of Contract 2. As a signatory to Contract 2, Party C effectively becomes a signatory to the contract containing the arbitration clause. In a dispute arising between B and C, therefore, either party could compel the other to arbitrate.[57] Furthermore, when incorporating by reference, parties can

56. *Thomson-CSF*, 64 F.3d at 777.

57. Naturally, in a dispute arising between A and B, either party could compel the other to arbitration, as both parties are (explicitly) signatories to the contract containing the arbitration clause.

choose to incorporate the contract in its entirety or to incorporate only certain clauses. Therefore, if either party objected to the arbitration clause, that part of Contract 1 should have been explicitly not incorporated.

The theory of incorporation by reference should thus encourage careful contract negotiations in which parties pay attention to every detail of what is being incorporated via reference to the prior contract. Because of the parties' freedom to negotiate every detail, including whether any portions of the contract will not be incorporated by reference, a party to a contract that incorporates a prior contract containing an arbitration clause cannot refuse arbitration.

B. Assumption

A nonsignatory may also be bound by the arbitration clause if the nonsignatory's subsequent conduct indicates that it has assumed the obligation to arbitrate.[58] For example, in *Gvozdenovic v. United Air Lines, Inc.*,[59] appellants contended that the district court improperly dismissed their petition for vacatur of the arbitration award because they were not signatories to the contract containing the arbitration agreement.[60] The Second Circuit refused to accept appellants' arguments. Because the nonsignatories had participated voluntarily and actively in the arbitration, they were bound by its outcome.[61]

The theory of assumption is consistent with traditional contract principles. When assuming a contract, the right to later claim nonsignatory status is effectively waived: "[P]articipation in an arbitration proceeding on the merits of a dispute will result in waiver of the right to raise the issue of arbitrability."[62] Traditional principles of contract law suggest that parties should not be allowed to act inconsistently or renege on their given word to the detriment of the other party. Refusing to allow parties to act in such an inconsistent and potentially deceptive manner encourages the parties to be honest and forthright in their relations. If the nonsignatory does not desire arbitration, then it needs to make that objectively clear, rather than acting in a manner consistent with willingness to arbitrate. Contract principles do not presume mind-reading abilities, and if the parties subjectively intend one result, then it is their responsibility to

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58. *Id.*

59. Gvozdenovic v. United Air Lines, Inc., 933 F.2d 1100 (2d. Cir. 1991).

60. *Id.* at 1103.

61. *Id.*

62. Eleanor L. Grossman, Annotation, *Participation in Arbitration Proceedings As Waiver of Objections to Arbitrability Under State Law*, 56 ALR 5th 757, 767 (1998).

manifest that intent on an objective level. If both the nonsignatory and the signatory have evidenced a willingness to arbitrate, then there is no question as to arbitrability, and the arbitration may proceed.

C. Agency

Traditional principles of agency law may bind a nonsignatory principal to an arbitration agreement when the signatory agent acted within the principal's actual, implied, or apparent authority.[63] It should come as no surprise that a principal, though technically a nonsignatory, may be bound to a contract that his agent signed on his behalf. An important characteristic of agency law is that "the agent has the power to bring about or alter business and legal relationships between the principal and third persons and between the principal and agent."[64] This power emanates from the " 'manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.' "[65] A principal is bound by the actions of his general agent "within the apparent scope of business for which the agent is employed."[66] Thus a nonsignatory principal can be compelled to arbitrate when his agent, acting in the scope of authority granted by the principal, signs a contract containing an arbitration clause.

D. Veil-Piercing/Alter Ego

A fourth theory by which courts will compel a nonsignatory to arbitrate is the veil-piercing theory, also known as the alter ego theory. Typically, the subsidiary of a parent company is a separate legal entity, and thus the parent company cannot be held liable for the subsidiary's actions—in other words, "a corporate relationship alone is not sufficient to bind a nonsignatory to an arbitration agreement."[67] In certain situations, however, the relationship between the two entities is such that the court will "pierce the corporate veil" and hold the parent company liable for the subsidiary's actions. This occurs "in two broad situations: to prevent fraud or other wrong, or where a parent dominates and controls a subsidiary."[68] This theory is closely related

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63. Thomson-CSF, S.A. v. Am. Arbitration Ass'n, 64 F.3d 773, 777 (2d Cir. 1995).

64. 3 AM. JUR. 2D *Agency* § 2 (2002).

65. Bridas Sapic v. Turkmenistan, 345 F.3d 347, 357 (5th Cir. 2003) (quoting RESTATEMENT (SECOND) OF AGENCY § 1(1) (1958)).

66. 3 AM. JUR. 2D *Agency* § 83 (2002).

67. *Thomson-CSF*, 64 F.3d at 777.

68. *Id.* (citations and quotation marks omitted).

to the agency strand, for the parent/subsidiary relationship is very similar to the principal/agent relationship.

Courts will only pierce the corporate veil in egregious circumstances. To pierce the veil to reach the parent company, the parent's domination and control of the subsidiary must be so complete that the two are virtually one and the same—the subsidiary is the mere instrumentality of the parent corporation. Courts make this determination by analyzing the facts and circumstances of the case. Factors considered may include:

> (1) the absence of the formalities and paraphernalia that are part and parcel of the corporate existence, i.e. issuance of stock, election of directors, keeping of corporate records and the like, (2) inadequate capitalization, (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes, (4) overlap in ownership, officers, directors, and personnel, (5) common office space, address and telephone numbers of corporate entities, (6) the amount of business discretion displayed by the allegedly dominated corporation, (7) whether the related corporations deal with the dominated corporation at arm's length, (8) whether the corporations are treated as independent profit centers, (9) the payment or guarantee of debts of the dominated corporation by other corporations in the group, and (10) whether the corporation in question had property that was used by other of the corporations as if it were its own.[69]

A party attempting to pierce the corporate veil thus must meet a heavy burden and demonstrate a relationship greater than mere ownership. America's corporate laws were specifically designed for the purpose of limiting liability; courts therefore impose a high hurdle on a party attempting to thwart this purpose and pierce the corporate veil. According to a recent decision by the Second Circuit,

> To hold [companies to a lower control standard] would defeat the ordinary and customary expectations of experienced business persons. The principal reasons corporations form wholly owned . . . subsidiaries is to insulate themselves from liability for the torts and contracts of the subsidiary . . . . The practice of dealing through a subsidiary is entirely appropriate and essential to our nation's conduct of . . . trade.[70]

The doctrine of veil-piercing is firmly embedded in American contract and corporate law and is therefore a normal tool in the arsenal of contract interpretation principles used to determine whether a nonsignatory can be compelled to arbitrate. Courts will pierce the corporate veil and compel a nonsignatory parent corporation to arbitrate upon the requisite showing of complete control and domination. They will do so because such control suggests that, in essence, the parent company itself signed the arbitration clause, even if it is technically the subsidiary's signature on the form.

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69. Carte Blanche (Singapore) Pte., Ltd. v. Diners Club Int'l, Inc., 2 F.3d 24, 26 (2d Cir. 1993) (citations omitted). It should be noted, however, that corporate law is a matter of state law and may vary from state to state.

70. Sarhank Group v. Oracle Corp., 404 F.3d 657, 662 (2d. Cir. 2005).

Courts, however, often blur the line between the parent/subsidiary context and equitable estoppel, allowing defendant parent companies to invoke the arbitration clause signed by their subsidiaries. As the Fourth Circuit noted,

> When the charges against a parent company and its subsidiary are based on the same facts and are inherently inseparable, a court may refer claims against the parent to arbitration even though the parent is not formally a party to the arbitration agreement.... "If the parent corporation was forced to try the case, the arbitration proceedings would be rendered meaningless and the federal policy in favor of arbitration effectively thwarted." The same result has been reached under a theory of equitable estoppel.[71]

Because these results may be reached under a theory of equitable estoppel (i.e., a nonsignatory defendant may compel the signatory plaintiff), courts sometimes improperly collapse the two factors to compel arbitration.[72] Courts must be extremely careful, however, not to compel parties who did not agree to arbitrate their claims to arbitrate. Despite the federal policy in favor of arbitration, courts can only compel arbitration by those parties who agreed to arbitrate in the first place, either by written agreement or contract and agency principles.[73] Therefore, when a nonsignatory parent company willingly agrees to arbitrate with a signatory who has filed suit against it in court—a so-called "defensive" use of veil-piercing in that the parent company volunteers to pierce the corporate veil[74]—the

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71. J.J. Ryan & Sons, Inc. v. Rbone Poulenc Textile, S.A., 863 F.2d 315, 320-21 (4th Cir. 1988) (quoting Sam Reisfeld & Son Import Co. v. S.A. Eteco, 530 F.2d 679, 681 (5th Cir. 1976)) (citation omitted). In this case, plaintiff J.J. Ryan & Sons, Inc. was the assignee of contracts with affiliates of defendant Rhone Poulenc Textile, S.A. *Id.* at 316. Rbone Poulenc, even though a nonsignatory to the contracts, was willing to arbitrate with J.J. Ryan & Sons. *Id.* at 320. The Fourth Circuit agreed with Rhone Poulenc simply because the parent was willing to arbitrate, even though the court did not analyze whether the parent and subsidiary were virtually one and the same. *Id.* at 320-21.

72. *See infra* Part IV B.2.. Scott M. McKinnis has argued that the *Sunkist* case, discussed *infra* text accompanying notes 86-98, was an appropriate use of the second strand of equitable estoppel. Scott M. McKinnis, *Enforcing Arbitration with a Nonsignatory: Equitable Estoppel and Defensive Piercing of the Corporate Veil*, 1995 J. DISP. RESOL. 197, 210-11. McKinnis argues, however, that the court "missed an excellent opportunity to step beyond the esoteric language of estoppel and base its *equitable decision* on the established rule of corporate instrumentality and alter ego doctrine." *Id.* at 211 (emphasis added). McKinnis argues that in situations with a signatory-plaintiff and a nonsignatory-defendant, the court could "defensively" pierce the corporate veil and compel the signatory "to arbitrate its claims with a nonsignatory parent." *Id.* This inappropriately collapses the two factors by substituting a so-called equitable principle for the principle of veil-piercing and allowing a nonsignatory who is not entitled to invoke the clause and who did not agree to arbitrate, either by contract or agency principles, to compel arbitration. Moreover, to the extent that the court fails to do an analysis for domination and control, this is in effect the second strand of equitable estoppel, an inappropriate basis for compelling arbitration.

73. Intergen N.V. v. Grina, 344 F.3d 134, 142 (1st Cir. 2003) (quoting AT&T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 648 (1986)).

74. *See* discussion *infra* Part IV.B.2.

court should first analyze domination and control.[75] This analysis should seek to determine whether the parent and subsidiary are virtually the same entity, thus rendering the parent an effective signatory. If not, a nonsignatory parent company's willingness to arbitrate should not trump the signatory's desire to remain in court because it is not clear that the parent and subsidiary are one and the same. Without such domination and control, the situation is in fact the second strand of equitable estoppel, which this Note argues is an inappropriate basis for compelling arbitration.[76]

IV. EQUITABLE ESTOPPEL

The current equitable estoppel analysis is by far the most disjointed theory used under the framework because the circuits do not uniformly apply it. Furthermore, the theory moves farthest away from traditional contract interpretation principles, thus potentially compelling arbitration where no agreement to arbitrate exists. This differs from the other four contract and agency principles used to compel arbitration. Under the other four principles, both parties have objectively manifested the intent to arbitrate.

Courts have used the term "equitable estoppel" to encompass two distinct versions of the doctrine: the first and second strands. As discussed in the following Sections, the first strand is based in valid contractual principles and is therefore a valid basis by which to compel a nonsignatory to arbitrate. The second strand, however, is not well-grounded in contract principles. Under the second strand, given that contractual principles cannot deduce an objective agreement between the parties, there is no valid basis by which to compel the parties to arbitrate.

A. The First Strand

The first strand of equitable estoppel examines the nature of the relationship between the nonsignatory and the contract itself.[77] Most courts recognize that "a party may be estopped from asserting that the lack of his signature on a written contract precludes enforcement of the contract's arbitration clause when he has consistently maintained that other provisions of the same contract

75. *See* Carte Blanche (Singapore) Pte. Ltd. v. Diners Club Int'l, Inc., 2 F.3d 24, 26 (2d Cir. 1991) (listing factors considered in a factual analysis of whether the parent company controlled the subsidiary such that they are legally considered the same).

76. *See* discussion *infra* Parts III.D, IV.

77. *See supra* note 15 and accompanying text.

should be enforced to benefit him."[78] Thus, a nonsignatory may be "equitably estopped from challenging an agreement that includes an arbitration clause when that person embraces the agreement and directly benefits from it."[79] In other words, if a nonsignatory were to sue on the contract, the signatory could invoke equitable estoppel and compel the nonsignatory to arbitrate the dispute. This particular use of equitable estoppel accords with contract principles and the parties' manifested intent. By relying on provisions of the contract to form a claim, the nonsignatory has manifested an objective intent to be bound by the contract, even if subjectively he did not intend such. Objective intent is the central focus of contract law. Courts look for "an agreement to arbitrate, under general principles of contract law . . . that is to say that the totality of the evidence supports an *objective* intention to agree to arbitrate."[80] Furthermore, the focus remains on the unwilling *non*signatory to arbitrate its claims. The first strand is therefore rooted in traditional contract principles and is used validly to compel a nonsignatory to arbitrate.

B. The Second Strand

The term "equitable estoppel" is also used to describe a theory that examines the nature of the relationships between the parties—the "second strand" of equitable estoppel. Courts that follow the second strand purport that a close relationship between the parties involved, coupled with a dispute closely related to the underlying contractual obligations, may be a basis to compel arbitration.[81] Under this theory, the doctrine of so-called equitable estoppel may allow a *nonsignatory* to compel a *signatory* to arbitrate.[82] In other words, "when a signatory resists arbitration, courts may use equitable estoppel to join a 'willing' nonsignatory to a proceeding where

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78. Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH, 206 F.3d 411, 418 (4th Cir. 2000).

79. Bouriez v. Carnegie Mellon Univ, 359 F.3d 292, 295 (3d Cir. 2004); *accord Int'l Paper*, 206 F.3d at 418 .

80. Sarhank Group v. Oracle Corp., 404 F.3d 657, 662 (2d Cir. 2005) (emphasis added).

81. *See, e.g.*, Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc., 10 F.3d 753, 757 (11th Cir. 1993).

82. Some courts find that the second strand is distinct and separate from the other contract and agency principles used to compel arbitration of a nonsignatory because it is the nonsignatory, and not the signatory, who seeks to invoke the clause. *See, e.g.*, Choctaw Generation Ltd. P'ship v. Am. Home Assurance Co., 271 F.3d 403, 406 (2d Cir. 2001). Usually, however, courts include the second strand in the context of the five principles because it is an estoppel theory. Even if courts such as the Second Circuit find that it is separate from the framework, they still analyze it in conjunction with the framework. Thus it is a (slight) distinction without a difference.

arbitration between the underlying signatory participants is appropriate."[83]

This Section will first discuss various examples of how the circuit courts have applied the second strand of equitable estoppel. It will then explain various nuances of its application, including how courts have improperly collapsed the second strand with the principle of veil-piercing/alter ego, how the second strand has been applied improperly when a claim sounds in tort, how the second strand is distinct from the first, and why the second strand of equitable estoppel is wholly invalid, despite the federal policy in favor of arbitration.

1. Evolution of the Second Strand in the Federal Circuit Courts of Appeals

Equitable estoppel is a rather nebulous principle, perhaps due to its shaky status as a principle of contract law. The Eleventh Circuit, however, has articulated the two situations in which a nonsignatory can compel the signatory to arbitrate:

> First, equitable estoppel applies when the signatory to a written agreement containing an arbitration clause must rely on the terms of the written agreement in asserting its claims against the nonsignatory.... Second, application of equitable estoppel is warranted when the signatory [to the contract containing the arbitration clause] raises allegations of substantially interdependent and concerted misconduct hy both the nonsignatory and one or more of the signatories to the contract.[84]

The Fifth Circuit has explicitly adopted this theory.[85]

These two sub-parts of the second strand of equitable estoppel build upon the Eleventh Circuit's analysis in *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*[86] In *Sunkist*, defendant-appellant Sunkist Growers, Inc. ("Sunkist") sold to General Cinema Corporation ("GCC") "the right to market and sell an orange soda under the 'Sunkist' brand name."[87] To produce and market the soft drink, GCC created a wholly-owned subsidiary, Sunkist Soft Drinks ("SSD").[88] SSD and Sunkist subsequently entered into a license agreement that included an arbitration clause.[89] Del Monte Corporation ("Del Monte") later bought SSD from GCC and absorbed SSD into its own beverage products

83. David F. Sawrie, *Equitable Estoppel and the Outer Boundaries of Federal Arbitration Law: The Alabama Supreme Court's Retrenchment of an Expansive Federal Policy Favoring Arbitration*, 51 VAND. L. REV. 721, 736 (1998).

84. MS Dealer Serv. Corp. v. Franklin, 177 F.3d 942, 947 (11th Cir. 1999) (citations and quotation marks omitted).

85. Grigson v. Creative Artists Agency, L.L.C., 210 F.3d 524, 527 (5th Cir. 2000).

86. 10 F.3d at 753.

87. *Id.* at 755.

88. *Id.*

89. *Id.*

division, "strip[ing] SSD of its employees and management and any other separate operating status."[90]

Del Monte's purchase of SSD and its total absorption of SSD into its own business brought into question SSD's performance under the license agreement with Sunkist.[91] Del Monte and SSD filed a declaratory relief action against Sunkist in the District Court for the Northern District of Georgia, seeking a declaration that these underlying controversies were subject to arbitration.[92] Sunkist filed counterclaims against Del Monte, in response to which Del Monte filed a motion to compel arbitration, claiming that "Sunkist was contractually obligated to arbitrate its claims under the terms of the license agreement."[93] Sunkist objected, contending that it neither consented to nor intended to arbitrate any claims with Del Monte.[94] Because Del Monte was not a signatory to the license agreement with SSD, Sunkist contended, Del Monte had no written agreement with Sunkist, and therefore Sunkist could not be compelled to arbitrate.[95]

Under a theory of equitable estoppel, the Eleventh Circuit dismissed Sunkist's arguments and compelled Sunkist, the unwilling signatory, to arbitrate its claims with Del Monte.[96] Even though the eleven counterclaims Sunkist had filed (arguably) sounded in tort, the court nonetheless found that each counterclaim arose from and related directly to the license agreement.[97] This close relationship to the contract, coupled with the close relationship of the entities, led the court to conclude that the claims were "intimately founded in and intertwined with the license agreement,"[98] thus precluding Sunkist from avoiding arbitration.

Similarly, the Seventh Circuit was one of the first circuits to apply the second strand of the equitable estoppel theory in *Hughes Masonry Co. v. Greater Clark County School Building Corp.*;[99] indeed, the *Sunkist* district court directly relied on this analysis.[100] In *Hughes*,

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90. *Id.*

91. *Id.* (noting the "controversy relating to SSD's performance under the license agreement").

92. *Id.* It does not appear, however, that Sunkist had yet filed suit; Del Monte and SSD seemed to be acting preemptively.

93. *Id.* at 755-56.

94. *Id.* at 757.

95. *Id.*

96. *Id.* at 758.

97. *Id.* *See also* discussion *infra* Part IV.B.3.

98. *Id.* (quoting McBro Planning & Dev. Co. v. Triangle Elec. Constr. Co., 741 F.2d 342, 344 (11th Cir. 1984)).

99. Hughes Masonry Co. v. Greater Clark County Sch. Bldg. Corp., 659 F.2d 836 (7th Cir. 1981).

100. *Sunkist*, 10 F.3d at 757.

the Hughes Masonry Company ("Hughes") entered into an agreement with the Greater Clark County School Building Corporation ("Clark") to provide masonry services for the construction of new middle schools.[101] This agreement incorporated an agreement to arbitrate all disputes arising out of the contract.[102] J.A. Construction Management Corporation ("J.A.") was designated as construction manager for the project.[103] When Clark terminated its contract with Hughes due to Hughes's alleged breach of its contractual obligations, Clark filed a demand to arbitrate its dispute with Hughes.[104] Hughes subsequently filed separate actions against both Clark and J.A. in U.S. District Court and in the Superior Court of Marion County, Indiana, respectively.[105] J.A. filed a motion to compel arbitration of all contract disputes between itself, Hughes, and Clark, which the district court denied.[106] J.A. appealed, and Hughes, the signatory to the agreement, argued that it could not be required to arbitrate because J.A. was a nonsignatory and therefore not entitled to invoke the arbitration clause.[107]

The Seventh Circuit, however, equitably estopped Hughes from making this argument because "the very basis of Hughes' claim against J.A. is that J.A. breached the duties and responsibilities assigned and ascribed to J.A. by the agreement between Clark and Hughes."[108] The court overlooked the fact that Hughes had characterized its complaint as sounding in tort because "[i]n substance . . . Hughes [was] attempting to hold J.A. to the terms of the Hughes-Clark agreement."[109] Instead, the court held that it would be "manifestly inequitable" to permit Hughes to have it both ways: to rely on the contract when it worked to its advantage and repudiate it when it worked to its disadvantage.[110]

Following the *Hughes* opinion, other circuits initially declined to adopt this analysis. For example, in *Thomson-CSF v. American Arbitration Ass'n*, the Second Circuit acknowledged that other courts of appeal were adopting this alternative estoppel theory, in which the

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101. *Hughes*, 659 F.2d at 837.

102. *Id.*

103. *Id.*

104. *Id.* at 838.

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.* at 839. Though generally I argue that the second strand of equitable estoppel is invalid, the court in *Hughes-Masonry* may indeed have recognized the one isolated situation in which the second strand may be valid. *See* discussion *infra* Part IV.B.3.

courts were "willing to estop a *signatory* from avoiding arbitration with a nonsignatory when the issues the nonsignatory [was] seeking to resolve in arbitration [were] intertwined with the agreement that the estoppel party has signed."[111] The *Thomson* court, however, declined to adopt such a theory. The court recognized the distinction between the two strands of estoppel, noting that other circuits had used the second strand to compel signatories to arbitrate with willing nonsignatories.[112] In the *Thomson* case, however, the signatory was seeking to compel the nonsignatory to arbitrate, so the second strand of equitable estoppel was inapplicable. Not only was it inapplicable to the particular case, but the court recognized that the nature of arbitration makes the distinction between the two forms of estoppel important, reiterating that arbitration is "*strictly* a matter of contract."[113] The second strand of equitable estoppel was further inapplicable because the nonsignatory could not be "estopped from denying the existence of an arbitration clause to which it is a signatory because no such clause exist[ed]."[114] The court, in essence, stated that the second strand of equitable estoppel is used to estop signatories who are trying to proceed in court from denying the existence of an arbitration clause. The nonsignatory in the case could not be estopped from denying the existence of such a clause, however, because it had never signed a contract; therefore, no such clause existed.

Not long after *Thomson*, however, the Second Circuit found a situation in which to apply the so-called "alternative" estoppel theory—the second strand—embraced in *Sunkist* and *MS Dealers*. In *Smith/Enron Cogeneration Ltd. v. Smith Cogeneration International*,[115] Smith Cogeneration International ("SCI") appealed from a district court order compelling arbitration of claims it asserted in a lawsuit against Smith/Enron Cogeneration Limited Partnership, Inc. ("SECLP").[116] SCI was a signatory to a series of agreements creating SECLP.[117] The agreements contained broad arbitration clauses.[118] When SCI filed suit against a number of Enron affiliates,[119] appellees SECLP and Enron International C.V. petitioned to compel

111. Thomson-CSF v. Am. Arbitration Ass'n, 64 F.3d 773, 779 (2d Cir. 1995).

112. *Id.*

113. *Id.* (emphasis added).

114. *Id.*

115. Smith/Enron Cogeneration Ltd. v. Smith Cogeneration Int'l, 198 F.3d 88 (2d Cir. 1999).

116. *Id.* at 90.

117. *Id.*

118. *Id.*

119. *Id.* at 91.

arbitration.[120] Thus the non-signatories to the agreement invited the court to pierce their own corporate veil and compel arbitration.[121] The district court granted the motion.[122]

SCI appealed, claiming that the there was no valid and enforceable agreement to arbitrate between the parties to the proceeding.[123] The court, however, found that the circumstances justified piercing the corporate veil.[124] The case fell within the second strand of equitable estoppel, a theory that the court had explicitly declined to adopt in *Thomson*: namely, this was a circumstance in which a signatory could be estopped from avoiding arbitration with the nonsignatory because the potentially arbitrable issues were closely intertwined with the signed agreement.[125] Having recognized the second strand of equitable estoppel, the Second Circuit continues to apply the doctrine. [126]

Likewise, the Fifth Circuit recognizes the second strand of equitable estoppel. In *Grigson v. Creative Artists Agency*, the Fifth Circuit explicitly adopted the Eleventh Circuit's language articulating the two strands of equitable estoppel.[127] The Fifth Circuit applied the second strand of equitable estoppel to compel two movie production companies, who were signatories to the contract, to arbitrate their claims with defendant nonsignatories.[128] The court opined that were it not to compel the plaintiff signatories to arbitrate, it would "fly in the face of fairness."[129]

The foregoing is a short discussion of the application of the equitable estoppel theory in the circuit courts. As demonstrated by these cases, circuit courts apply the second strand of equitable estoppel. The following subsections will focus on some of the problems underlying this approach.

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120. *Id.*

121. *Id.* at 97. Even though this was an equitable estoppel theory case, the fact that the court found that it justified piercing the corporate veil shows how courts will sometimes collapse tbe veil-piercing factor and the second strand. *See supra* note 72. Both the collapsing and the underlying "equitable" principles used to compel the unwilling signatory to arbitration are improper.

122. *Smith/Enron*, 198 F.3d at 91.

123. *Id.* at 95.

124. *Id.* at 97.

125. *Id.* at 98.

126. *See, e.g.*, JLM Indus., Inc. v. Stolt-Nielsen SA, 387 F.3d 163 (2d Cir. 2004); Choctaw Generation Ltd. P'ship v. Am. Home Assurance Co., 271 F.3d 403 (2d Cir. 2001).

127. Grigson v. Creative Artists Agency, L.L.C., 210 F.3d 524, 527 (5th Cir. 2000) (quoting MS Dealer Corp. v. Franklin, 177 F.3d 942, 947 (11th Cir. 1999)).

128. *Id.* at 525, 527-31.

129. *Id.* at 528.

2. The Complication of Veil-Piercing/Alter Ego Theories

Courts often collapse the veil-piercing/alter ego theory with the second strand of equitable estoppel. As this Note will argue, though veil-piercing/alter ego can be a valid contract and agency principle used to compel nonsignatories to arbitrate, the second strand of equitable estoppel is not. Applying the second strand, even when collapsed with the veil-piercing/alter ego principle, is an invalid means of compelling arbitration of a nonsignatory because it is not grounded in contract and agency principles.

The Third Circuit has, however unintentionally, collapsed these two principles, thereby obfuscating the already nebulous principle of equitable estoppel even further. In *E.I. Dupont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Intermediates, S.A.S.*,[130] the Third Circuit acknowledged in dicta the equitable estoppel theory,[131] which it had never applied before, though it declined to apply it to the particular facts. The court did not, however, preclude the doctrine from being applied in future cases: "[T]here appears to be no reason why, in an appropriate case, we would refrain from [applying the doctrine of equitable estoppel]."[132] The court acknowledged two theories: situations in which the nonsignatory knowingly exploits the agreement (the first strand), and situations in which the signatory is bound to arbitrate because of the close relationship and the fact that the claims were intertwined (the second strand).[133] The court noted that when the *signatory* is compelled to arbitrate due to the close relationship, "[i]n essence, a non-signatory voluntarily pierces its own veil to arbitrate claims against a signatory that are derivative of its corporate-subsidiary's claims against the same signatory."[134]

Acknowledging that the nonsignatory voluntarily pierced its own veil complicates the matter.[135] In so doing, the Third Circuit improperly collapsed the veil-piercing principle into the equitable estoppel analysis, when the two properly should be distinct theories.[136] The court stated,

> With reference to the second theory of equitable estoppel, appellants rely on a series of cases in which signatories were held to arbitrate related claims against parent

130. E.I. Dupont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Intermediates, S.A.S., 269 F.3d 187 (3d Cir. 2001).

131. *Id.* at 199-202.

132. *Id.* at 199.

133. *Id.*

134. *Id.* at 201.

135. *See supra* note 72.

136. *See supra* text accompanying notes 72.

> companies who were not signatories to the arbitration clause. . . . In essence, a nonsignatory voluntarily pierces its own veil to arbitrate claims against a signatory that are derivative of its corporate-subsidiary's claims against the same signatory.[137]

Appellants argued that though the cases cited would bind a signatory plaintiff to arbitration, nevertheless they were applicable and would bind a nonsignatory plaintiff. The court rejected this argument, but in so doing, it managed to confuse the principles of veil-piercing/alter ego and both strands of equitable estoppel. The court failed to acknowledge that equitable estoppel is distinct from the principle of veil-piercing/alter ego. This is not the second strand of equitable estoppel; rather, it is a case of a signatory defendant compelling a parent corporation to arbitrate because its domination and control of the nonsignatory render them effectively the same entity. As discussed above, if the parent company meets the requisite standard of domination and control, a nonsignatory parent company can compel a signatory plaintiff to arbitrate. This is so because the parent company, as an alter-ego of the subsidiary, is a signatory to the contract. By failing to recognize the distinction between the two theories, as well as failing to undertake an analysis of domination and control, the Third Circuit confused the second strand of estoppel even further.[138]

3. Recasting a Complaint in Tort as Sounding in Contract

The second strand of equitable estoppel also suffers from the courts' eagerness to recast tort complaints as sounding in contract. It is true that a party cannot avoid broad language in an arbitration agreement by cleverly attempting to cast its complaint in tort rather than contract (an attempt that, if successful, would render the

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137. *E.I. Dupont*, 269 F.3d at 201.

138. The court made further mistakes in its analysis. The Third Circuit quoted the *Thomson* court, stating:

> As these cases indicate, the circuits have been willing to estop a *signatory* 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. As the district court pointed out, however, 'the situation here is the inverse: E&S, the signatory, seeks to compel Thomson, a non-signatory.'

Id. at 202 (quoting Thomson-CSF, S.A. v. Am. Arbitration Ass'n, 64 F.3d 773,779 (2d Cir. 1995)). The court acknowledged that the second strand of equitable estoppel is valid—that a signatory may be estopped if the "issues are intertwined"—even though this may not be sufficient to constitute an agreement to arbitrate. As this Note argues, however, the second strand of estoppel is not valid and there is no agreement to arbitrate. The court also invalidated the first strand of estoppel in stating that a signatory defendant may not be able to compel a nonsignatory plaintiff. This Note argues, however, that the first strand is valid. Moreover, under the other four principles, a signatory defendant may compel a nonsignatory plaintiff to arbitrate.

contractual provisions irrelevant).[139] Furthermore, in certain cases the pleadings truly were based in contract. For example, in *Hughes Masonry*, in the first count of its amended complaint, Hughes pleaded that "Clark and/or its construction manager" (the nonsignatory) were in default of the Hughes-Clark agreement.[140] Though the third count sounded in tort, the court determined that the acts that Hughes alleged were essentially failure to perform duties described in the Hughes-Clark contract.[141] Hughes had merely attempted to characterize the nonsignatory's alleged failures to perform duties under the contract as tortious interferences with its contractual relations with Clark.[142] This therefore may be the rare isolated case where it is acceptable to use the second strand of equitable estoppel to compel an unwilling signatory to arbitrate with a willing signatory.[143]

Yet the *Hughes-Masonry* situation is the exception to the norm, since typically in situations involving a signatory and a nonsignatory there is no contractual relationship. Thus pure tort claims are appropriate, and courts should not be so eager to recast the claims in contract just to compel the parties to arbitrate. The second strand of equitable estoppel is distinct from the other legitimate principles because it focuses on the nature of the parties' *relationship*. Even though there might be a close circumstantial connection to the contract, this does not mean that the cause of action is based on duties arising out of the contract itself.

For example, in *McBro Planning & Development Co. v. Triangle Electrical Construction Co.*, Triangle pleaded its claims in tort counts—intentional interference with contract and negligence—claiming that McBro had harassed and hampered its work.[144] The two parties did not have a written arbitration agreement between themselves, yet each party had contracted with St. Margaret's

139. McBro Planning & Dev. Co. v. Triangle Elec. Constr. Co., 741 F.2d 342, 344 (11th Cir. 1984).

140. Hughes Masonry Co. v. Greater Clark County Sch. Bldg. Corp., 659 F.2d 836, 839 (7th Cir. 1981).

141. *Id.* at 840.

142. *Id.*

143. Because there was in fact a failure to perform contractual duties, the use of estoppel was not a false attempt to transform the nature of the relationship into a contractual one; rather, the relationship was already contractual in nature. In the typical use of the second strand, however, a court uses the doctrine in a weak attempt to characterize the relationship as contractual, where in fact, as this Note argues, it is not. Because of the inherent contractual relationship in the *Hughes* case, which was merely a function of the particular facts of the case, compulsion of arbitration was thus proper.

144. *McBro*, 741 F.2d at 343. A contract count under a third-party beneficiary theory was subsequently dropped. *Id.*

Hospital regarding hospital renovations and additions. Both of these contracts contained written arbitration agreements.[145]

This is a clear example of a tort case, and yet the court decided that the close relationship of the three parties warranted arbitration under the two separate contracts.[146] The court disregarded the fact that the Triangle-St. Margaret contract explicitly stated that "nothing contained in the Contract documents shall create any contractual relationship between the Construction Manager [McBro] and the Contractor [Triangle]."[147] A court should hesitate before it recasts a tort pleading as a contract pleading in order to compel the parties to arbitrate. Recasting a tort pleading as a contract pleading without the necessary analysis of whether there was truly an agreement does not satisfy the requirement of an agreement to arbitrate.

Furthermore, while it is true that even a tort claim could be arbitrated under the arbitration clause, the court must still undertake the analysis of whether there was a contractual agreement to arbitrate. The mere fact that the close relationship of the parties involved may be related circumstantially to a contract does not mean that there was a sufficient contractual agreement. Therefore, a court cannot circumvent the fundamental necessity of an arbitration agreement simply by manipulating the form of the pleadings. Regardless of whether the claim sounds in tort or contract, before a court can compel parties to arbitrate, it must analyze the relationship of the parties to the contract to determine whether there was an agreement to arbitrate.

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145. *Id.* at 342.

146. *Id.* at 342-43.

147. *Id.* at 343 (internal quotations omitted). Moreover, in recasting the complaint as a contract claim, the *McBro* court gave great weight to the fact that Triangle had originally pleaded a third-party beneficiary claim, which sounds in contract, even though Triangle later amended its pleadings. *Id.* at 342. By giving such evidentiary weight to a withdrawn pleading, the court effectively rendered amended pleadings worthless. Some circuits, however, have properly recognized that the original complaint has very limited significance. For example, in *Intergen N.V. v. Grina*, 344 F.3d 134 (1st Cir. 2003), none of the parties to the case was a signatory to any of the five agreements associated with the complaint. *Id.* at 143. Defendants moved to compel arbitration, and plaintiffs claimed that they had neither signed any of the underlying contracts nor agreed to arbitrate the claims asserted in the complaint. *Id.* at 140. Defendants tried to argue an equitable estoppel theory, focusing on an allegation made only in the original complaint that plaintiff was " 'the successor to all rights of predecessor entities related to the actions and omissions alleged.' " *Id.* at 145. The court rejected this argument on the basis that original complaints have very limited significance in litigation. *Id.* After examining the facts, the court declined to apply equitable estoppel because the plaintiffs did not embrace the contracts or seek to derive direct benefits from this. *Id.* at 146. This would be the first strand of equitable estoppel. After considering other arguments for why the parties should be compelled to arbitrate their dispute, the motion to compel arbitration was denied. *Id.* at 150.

4. Entitlement to Invoke the Arbitration Clause and Lack of an Agreement to Arbitrate

The fundamental problem with the second strand of equitable estoppel, notwithstanding the aforementioned complications, is that a nonsignatory is not entitled to invoke the arbitration clause because there is no mutual agreement to arbitrate, the fundamental requisite for arbitration.[148] As the First Circuit stated in *Intergen N.V. v. Grina*, a party who attempts to compel arbitration must show that he is entitled to invoke the arbitration clause.[149] This highlights what may be the biggest problem with the second strand of the equitable estoppel doctrine: the party invoking the arbitration clause is not *entitled* to invoke it. Under the other four theories (incorporation by reference, assumption, agency, and veil-piercing/alter ego), as well as the first strand of equitable estoppel, it is the signatory, clearly a party entitled to invoke the clause, who invokes it. Yet, as the Fifth Circuit noted, "As a general rule, an arbitration clause cannot be invoked by a non-party to the arbitration contract."[150] The non-signatory is not entitled because "[t]he right to compel arbitration stems from a contractual right."[151] A nonsignatory who was not a party to the agreement, as evidenced by a signature to the contract or under the principles of contractual interpretation or agency law, is therefore not entitled to invoke the arbitration clause.

Under the second strand of the equitable estoppel theory, courts examine the nature of the relationship between the parties, not the relationship to the contract and the duties and obligations arising out of traditional contract or agency principles. The courts do, however, pay lip service to the relationship being "intimately founded in and intertwined with the underlying contract obligations."[152] Typically, the relationship is circumstantially related to the contract, rather than arising out of the contractual agreement itself. Without a contractual relationship, the nonsignatory is not entitled to invoke the arbitration clause; therefore, the second strand of equitable estoppel is an improper basis for compelling arbitration.

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148. 9 U.S.C. § 2 (2006); *e.g.*, AT&T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 648 (1986). This is distinct from the first strand. This Note argues that, in the first strand, the nonsignatory indeed has manifested an objective intent to arbitrate its claims. *See* discussion *supra* Part IV.A.

149. *Intergen*, 344 F.3d at 142.

150. Grigson v. Creative Artists Agency, L.L.C., 210 F.3d 524, 532 (5th Cir. 2000) (Dennis, J., dissenting).

151. Britton v. Co-Op Banking Group, 4 F.3d 742, 744 (9th Cir. 1993).

152. Hughes Masonry Co. v. Greater Clark County Sch. Bldg. Corp., 659 F.2d 836, 841 n.9 (7th Cir. 1981).

Furthermore, even though there is a federal policy in favor of arbitration, *only* parties that agreed to arbitrate may be forced to arbitrate.[153] Even a strong federal policy in favor of arbitration cannot go so far as to compel parties to arbitrate when they never agreed to in the first place, whether the agreement is evidenced by an explicit contract or whether it is objectively manifested by other means recognized under general contractual principles. As Sawrie noted,

> Assent to arbitrate a broad range of disputes, however, does not necessarily signify assent to arbitrate those disputes with nonsignatories. Even if a party agreed to arbitrate a long range of disputes arising under a contract, that party might reasonably argue that it specifically agreed to arbitrate those disputes only with other contracting parties.[154]

The policy justifications for equitable estoppel unveil further problems. "Equitable estoppel is intended to prevent a party from taking unconscionable advantage of its own wrong by asserting its strict legal rights."[155] But in the scope of compulsion to arbitrate, is it really unconscionable to send a party to court rather than arbitration? In court, parties gain the protections of formal rules of evidence and civil procedure, stare decisis, and public opinions.[156] Furthermore, in the classic situation in which the circuit courts apply the second strand of the doctrine, the signatory files suit in district court and the "willing" nonsignatory files a motion to compel arbitration. By filing suit, the signatory is trying to prove *that it was wronged*—not take advantage of its own wrong.

This is not to say that the entire doctrine of equitable estoppel is a misplaced theory. There are policy reasons supporting at least the first strand of the theory.[157] We should encourage parties to act consistently and not take unfair advantage of the other party. Yet the use of the second strand of the doctrine to compel unwilling signatories to arbitrate has been stretched too far beyond the boundaries of contract interpretation principles. Courts have extended the federal policy in favor of arbitration to compel the unwilling

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153. *Intergen*, 344 F.3d at 142.

154. Sawrie, *supra* note 83, at 730.

155. 28 AM. JUR. 2D *Estoppel and Waiver* § 30 (2006).

156 *See* discussion *supra* Part II.B.

157. For an interesting discussion of equitable estoppel proposing an opposing view, see J. Douglas Uloth & J. Hamilton Rial, III, *Equitable Estoppel as a Basis for Compelling Nonsignatories to Arbitrate - A Bridge Too Far?*, 21 REV. LITIG. 593 (2002). Uloth and Rial argue that the second strand is the proper application of equitable estoppel: "[E]quitable estoppel applies *only* when a nonsignatory defendant seeks to compel arbitration with a signatory plaintiff." *Id.* at 633 (emphasis added). Even though Uloth and Rial recognize that the expansion of equitable estoppel might dwarf the "fundamental premise that a party cannot be compelled to arbitrate a matter without its agreement," *id.* at 632, they argue that it is unreasonable for a party who has signed nothing to find himself compelled to arbitrate its claims, and that the expansion of two theories of equitable estoppel might have constitutional implications. *Id.* at 633.

signatories to arbitrate, even when there was no agreement to arbitrate, written or otherwise, inferred from traditional contract interpretation.

The second strand of the equitable estoppel doctrine thus is fraught with inconsistencies and poor reasoning that should make courts hesitant to apply it, not more eager to do so. In particular, the focus on the nonsignatory is misplaced. A nonsignatory may not validly compel a signatory to arbitrate when the signatory wishes to sue.[158] The nonsignatory is not entitled to invoke the written agreement, even though the signatory may be entitled to invoke it against the nonsignatory.[159] There is no reason why a nonsignatory who did not enter into a written agreement with the signatory should nevertheless have the power to compel the signatory to arbitrate.

Courts also improperly blur the delineation between the equitable estoppel doctrine and the other four principles by which a court can compel a nonsignatory to arbitrate. Courts' eagerness to recast tort claims as sounding in contract in order to circumvent the requirement of an agreement to arbitrate extends the equitable estoppel doctrine beyond its appropriate limits. Furthermore, the circuit courts have stretched the second strand of equitable estoppel so thin that they are compelling parties to arbitrate even absent an arbitration agreement

The doctrine of equitable estoppel must therefore be refashioned to conform to traditional principles of contract and agency law.

V. SOLUTION: ERADICATING THE SECOND STRAND OF EQUITABLE ESTOPPEL TO MAINTAIN VALID CONTRACT AND AGENCY LAW PRINCIPLES

One commentator has argued that preventing courts from compelling arbitration unless the parties agreed to arbitrate conflicts with the expansive enforcement policy of federal arbitration law.[160]

158. By this is a nonsignatory in the truest sense of the word—in other words, the principle of incorporation by reference is still valid. As stated above, under the principle of incorporation by reference, a "nonsignatory" to the contract being incorporated may be entitled to compel the signatory to arbitration. But by incorporating by reference, the nonsignatory effectively becomes a signatory to the first contract, at least with regard to claims it can raise against the party with whom it is contracting. *See* discussion *supra* Part III.A.

159. When a signatory is being sued by a nonsignatory, it is entitled to invoke the agreement and compel the nonsignatory to arbitration under any theory of the five part framework: incorporation by reference, assumption, agency, veil-piercing/alter ego, or the first strand of equitable estoppel. This necessarily results in an asymmetry, in that the signatory is entitled to invoke the clause against the nonsignatory, and not vice versa.

160. Sawrie, *supra* note 83, at 726.

"To resolve this conflict, federal courts have applied theories such as . . . equitable estoppel to strike an appropriate balance."[161] Yet there is no need to strike an "appropriate balance"; indeed, doing so would subvert the FAA's plain words. Despite the strong policy in favor of arbitration, contract principles should *always* trump. The FAA itself requires an agreement to arbitrate before a court can compel a party to arbitrate.[162]

Although the first strand of equitable estoppel comports with the FAA's plain meaning, the second strand does not. The first strand of equitable estoppel, under which the courts examine whether a plaintiff-nonsignatory is exploiting the contract to his benefit such that there is sufficient objective intent to arbitrate, is consistent with this notion that the contract principles should trump. But those courts that have used the second strand of equitable estoppel to examine the parties' relationship to one another overreach by elevating the policy in favor of arbitration even above traditional contract principles. As one commentator noted, the *Grigson* court "conformed to the liberal federal policy favoring arbitration."[163] Yet the commentator also conceded that "[t]he *Grigson* court applied the doctrine of equitable estoppel to allow a nonsignatory to a contract to compel arbitration against a party who *neither contractually agreed to arbitration*, nor submitted to arbitration with the nonsignatory."[164] This is illustrative of cases in which courts apply the second strand of equitable estoppel. Indeed, these courts will go so far as to compel an unwilling signatory to arbitrate with a willing signatory even when the connection between the claim and the contract is weak.[165] Despite their eagerness to effectuate the federal policy in favor of arbitration, courts cannot overlook the requirement that there be an agreement to arbitrate.[166]

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161. *Id.*

162. 9 U.S.C. § 4 (2006). Section 4 provides that a party aggrieved by a failure to arbitrate under a *written* agreement for arhitration may petition any United States district court with appropriate jurisdiction to order arbitration in the manner provided for in the agreement. *Id.* Courts of course have not confined this to written agreements, but instead have applied traditional contract and agency principles to determine whether there was an agreement to arbitrate. *See, e.g.*, McAllister Bros., Inc. v. A & S Transp. Co., 621 F.2d 519, 524 (2d Cir. 1980) ("[A] party may be bound by an agreement to arbitrate even in the absence of a signature.").

163. Holly M. Roberts, Casenote, Grigson v. Creative Artists Agency: *Signatories "Can't Have it Both Ways" – Nonsignatories to a Contract Agreement Now Have Standing to Compel Arbitration*, 47 LOY. L. REV. 963, 978 (2001). *Grigson v. Creative Artists Agency, L.L.C.* is a Fifth Circuit case adopting the equitable estoppel theory that the Eleventh Circuit articulated in *MS Dealers*. Grigson v. Creative Artists Agency, L.L.C., 210 F.3d 524, 527 (5th Cir. 2000).

164. *Id.* at 977-78 (emphasis added).

165. Sawrie, *supra* note 83, at 741.

166. In finding such an agreement, courts must use the traditional rules of contract interpretation. "One important constraint [on the] federal policy favoring arbitration [is that the

Therefore, the focus of the "equitable estoppel" doctrine in determining whether to compel a nonsignatory to arbitrate should be realigned to one relationship only: The relationship of the nonsignatory to the *contract*. To implement this realignment, courts should completely eliminate the use of the second strand of equitable estoppel. Focusing merely on the relationship between the two parties ignores the most important element of arbitration: an agreement to arbitrate. This agreement arises out of an alignment of objectively manifested intent to be bound by the contract. Under the other theories by which a nonsignatory can be compelled to arbitrate—incorporation by reference, assumption, agency, and veil piercing/alter ego—there is such an alignment. The signatory's intent to be bound by the contract is manifested in the contract itself, and the nonsignatory's intent is objectively manifested through the traditional contract and agency principles. Courts effectively assign the nonsignatory the requisite intent based on these principles. Similarly, for the first strand of equitable estoppel, the nonsignatory has manifested its objective intent to be bound by the contract. If the nonsignatory has directly benefited from and embraced the contract, yet then tries to exploit his position by suing on the contract, it follows that he should be held to the terms of the contract—and thus compelled to arbitrate.

With the second strand of equitable estoppel, however, there is not always the same alignment of objectively manifested intent to be bound by the contract. Oftentimes the signatory is suing in tort, which in part demonstrates the lack of a contractual relationship between the two parties.[167] Furthermore, the nonsignatory has not necessarily manifested the intent to be bound by the contract itself—it has simply stated that it is willing to proceed in arbitration. Even if it were willing to be bound by the contract, there is still the problem of the signatory's lack of assent, and thus absence of a mutual agreement. Notwithstanding the propriety of the first strand of equitable estoppel, under which a signatory can compel a nonsignatory who is exploiting the benefits of the contract to arbitrate the dispute, the equitable estoppel doctrine should *not* work in the opposite direction: only the signatory is entitled to invoke the arbitration clause. In the instance of a mere relationship between the parties, not contractual in nature, the signatory should be allowed to proceed in court if he so chooses.

Advocates of the second strand of equitable estoppel have argued that the signatory is acting with "unacceptable motives" by

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policy] does not totally displace ordinary rules of contract interpretation." Paul Revere Variable Annuity Ins. Co. v. Kirschhofer, 226 F.3d 15, 25 (1st Cir. 2000).

167. *See* discussion *supra* Part IV.B.3.

adding a nonsignatory defendant to a claim.[168] This so-called "artful circumnavigation" of arbitration by suing a nonsignatory allegedly thwarts the federal policy in favor of arbitration. An equitable estoppel theory allowing the compulsion of the unwilling signatory to arbitrate therefore is warranted, despite the absence of an agreement to arbitrate.[169] Yet, this argument is rather weak. First, a signatory suing a nonsignatory isn't absolutely dodging its obligations under the written agreement. If the signatory were to sue the other signatory, the two parties would undoubtedly move to arbitrate under the agreement. Yet the mere fact that the signatory is arbitrating with the other signatory does not mean that it should have to arbitrate its dispute with a nonsignatory, a party with whom it did not negotiate and contract to arbitrate. Second, what if the signatory is not trying to be clever and thwart the court system, but has a truly valid claim against the nonsignatory? Though arbitration is an attractive option, there are reasons why a party would want its dispute to be heard in a court, rather than by an arbitrator.[170] An innocent signatory should not have to give up its right to a judicial hearing with a nonsignatory.

Most importantly, arguments in favor of the second strand fail because they disregard the first and foremost requirement for arbitration: an agreement to arbitrate. Though it may appear that the signatory is acting with unacceptable motives, the doctrine of equitable estoppel is not the proper vehicle to deal with the situation. Because there simply is no agreement to arbitrate, the courts cannot compel the signatory to arbitrate, regardless of the signatory's motives.

Furthermore, the fact that the signatory expended the time and effort to negotiate with the other signatory might show its preference for contracting. The focus of the relationship between the nonsignatory and the signatory allows courts to bypass the signatory's efforts in negotiating a contract. Parties take the time and effort to put their agreement in writing in part because they fear losing those negotiated rights in the future. Courts should not disregard the fact that the signatory wanted to protect certain rights vis à vis the other signatory. We can infer, from the lack of a contract with the nonsignatory, that the signatory wished to leave certain contingencies open. Perhaps most importantly, the fact that the signatory did not

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168. *Id.* at 731 ("Intuition supports the . . . argument that the plaintiff cannot dodge arbitration by adding a nonsignatory defendant to the complaint.").

169. *Id.*

170. For example, parties usually have a choice as to the arbitrator, which raises a real possibility of bias. A party may want an impartial judge to hear the dispute so as to eliminate this possibility of bias. Arbitration also eliminates the possibility of appeal, and the arbitrator may in effect escape from the rules of *stare decisis* and established precedent.

negotiate an arbitration clause with the nonsignatory, despite its agreement with the other signatory, seems to demonstrate that it wanted to protect its right to proceed in court with respect to the nonsignatory.

Therefore, a complete elimination of the second strand of equitable estoppel will validate the compulsion of nonsignatories to arbitrate. Because it completely disregards whether there was an agreement to arbitrate, the second strand of equitable estoppel is not a valid principle by which courts can compel a nonsignatory to arbitrate. In the absence of the other four principles by which a court can compel a nonsignatory to arbitrate, or even a situation in which the first strand of equitable estoppel is applicable, the claim must remain in court.

VI. CONCLUSION

Despite a federal policy in favor of arbitration, brought about by the enactment of the Federal Arbitration Act, there is a fundamental requirement that must be met before a court can compel parties to arbitrate: The parties must have agreed to arbitrate their dispute. Otherwise, the claim must remain in court.

Agreement to arbitrate, however, can be manifested in many different ways, and as demonstrated above, even nonsignatories to a written agreement may have agreed to arbitrate with the signatories. Whether the parties have agreed to arbitrate is typically a consideration for the courts. To ascertain whether such an agreement exists, the courts are bound only by traditional contract principles. When the dispute includes a nonsignatory, courts use five factors to interpret whether agreement exists: incorporation by reference, assumption, agency, veil-piercing/alter ego, and equitable estoppel. Over time, however, courts have been so eager to effectuate the federal policy in favor of arbitration that they have forgotten the most important prerequisite for compelling arbitration: an agreement to arbitrate. Thus, courts have used the equitable estoppel theory to compel plaintiff-signatories to arbitrate, improperly disregarding the fundamental need for a contractual agreement between the two parties to arbitrate.

To resolve this problem, the second strand of equitable estoppel should be wholly eliminated. This will constrain the courts and ensure that only parties who agreed to arbitrate are required to do so. Arbitration may be attractive to some parties, but the judicial forum is still preferential to others. Courts must avoid exploiting their powers by compelling parties to arbitrate as a means by which to clear their own dockets. Eliminating the second strand will properly effectuate

the parties' intent and properly implement the Federal Arbitration Act.

Alexandra Anne Hui[*]

[*] I would like to dedicate this Note in loving memory of my grandparents, Dupree and Wanda Fountain. I would also like to thank my parents, sisters, and family for their continued love, support, and devotion. Finally, I would like to thank Professor Erin O'Hara for her helpful comments on a draft of this piece, as well as the *Law Review* staff members for their insightful comments and suggestions.