

Nonsignatories Bound by an Arbitration Clause in Franchise Cases

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Written by Craig R. Tractenberg

The first case future U.S. Supreme Court Justice John Roberts argued in private practice was on behalf of Manny and Carol Kaplan. Their family securities trading business suffered during the 1987 stock market crash and the clearing house was taking advantage. The clearing house brought an arbitration not only against their business but against them personally when they had not personally agreed to arbitration. The case of *First Chicago Options of Chicago v. Kaplan*, 514 U.S. 938 (1995) held that the Kaplans had not agreed to have the arbitrator decide arbitrability and vacated an award against the Kaplans

Nevertheless, parties that never signed an arbitration agreement can still be required to arbitrate. Arbitration is a creature of state law contract principles "if that law arose to govern issues concerning the validity, revocability and enforceability of contracts generally," see *Perry v. Thomas*, 482 U.S. 483, 493 n. 9 (1987). Because "traditional principles" of state law allow a contract to be enforced by or against nonparties to the contract through "assumption, piercing the corporate veil, alter ego, incorporation by reference, third-party beneficiary theories, waiver and estoppel," as in *Arthur Andersen v. Carlisle*, 556 U.S. 624 (2009).

As a general rule, only a party to an arbitration clause and third-party beneficiaries can enforce it. A nonparty cannot except for certain circumstances. One of those circumstances is agency. If a party signs the arbitration agreement as an agent for a principal, the disclosed principal has a right to enforce that agreement

Another is equitable estoppel that can apply in three circumstances. If a party to an agreement with an arbitration clause must rely on the terms of that agreement to enforce it against a nonsignatory, and the claims against the non-signatory arise out of and are dependent on the terms of the contract, then arbitration is appropriate. A second is where the claims allege substantial and interdependent concerted misconduct between a signatory and a nonsignatory. A third instance is where there is a close relationship between the nonsigning party's conduct under the contract and the alleged wrong and the claims are intimately founded in and intertwined with the contract requirements

Nonsignatory Arbitration in Franchise Cases

- **Inclusion of issues and parties permitted nonsignatories to be joined.**

In *Doctor's Associates v. Burr-CCH* ¶15,891 (D. Conn., Dec. 28, 2016), the Subway franchisor petitioned to compel arbitration of claims asserted in California state court by the Burrs, unsuccessful franchisee applicants for a casino location. The Burrs claimed that the development agents eventually awarded the franchise interfered with their candidacy.

The federal district court in Connecticut held that the arbitration agreement in the Burrs' franchise application required arbitration of state court claims against the development agents, even though the agents were not parties to the arbitration agreement.

The Burrs alleged that, in 2013, the Morongo Tribal Council approved them to be the new Subway franchisee located inside the Morongo Casino and Hotel Spa. The Burrs then applied to the Subway franchisor in early 2014. The scope of the arbitration clause provided: "I agree that I will settle any and all previously unasserted claims, disputes or controversies arising out of or relating to my application or candidacy for the grant of a Subway franchise from the franchisor, pursuant to the laws of Connecticut, USA and by binding arbitration only."

The Burrs alleged that, after considering their application, the franchisor eventually awarded the franchise to the development agents, the Marwahas. The Burrs filed suit in California state court claiming that the Marwahas allegedly caused the franchisor to withdraw its acceptance of the Burrs so the Marwahas "could steal the franchise for themselves." The Burrs asserted claims against the Marwahas for intentional misrepresentation, interference with contractual relations and prospective economic relations and unfair business practices. The Subway franchisor then filed an arbitration against the Burrs for declaratory relief relating to the facts of the underlying California state court lawsuit in addition to filing its petition to compel arbitration.

The Burrs argued that the California lawsuit was outside of the scope of the arbitration clause because the Marwahas were not

parties to the arbitration agreement, were not acting in their capacity of development agents when they committed the business torts and the Burrs never agreed to arbitrate with the Marwahas.

The court determined that the scope of the clause included the intentional torts alleged because all arose out of the Burrs' candidacy for a franchise. Similarly, the court found the absence of the Marwahas from the arbitration contract to be unavailing. The arbitration provision contained a broad reference to claims, which could encompass claims against nonparties to the agreement. The clause did not limit the Burrs to arbitration only against parties to the agreement. Furthermore, the Burrs tried to distance the Marwahas from Subway claiming that they were sued in their individual capacities rather than their conduct as Subway development agents. The court cited precedent that "repeatedly held that a 'court will not permit plaintiffs to avoid arbitration simply by naming individual agents of the party to the arbitration clause and suing them in their individual capacities ... to do so would be to subvert the federal policy favoring arbitration and the specific arbitration clause in the instant case.'"

In summary, the court concluded that even though the Burrs did not agree to arbitrate against persons who were not parties to the arbitration, they did agree to arbitrate all claims, which could include related parties within the scope of the arbitrable claims. The court noted that the Subway franchisor "did not seek to compel the Burrs to arbitrate with the Marwahas ... rather, DAI

Subway seeks to compel the 'Burrs to arbitrate with DAI their claims against' the Marwahas."

- **Equitable estoppel is applied to compel arbitration of case against non-signatories, even after discovery was taken.**

In *Hyung Wook Kim v. Bruce Kim*, CCH Business Franchise Guide ¶15,867 (Ill. App., Nov. 30, 2016) the franchisee was equitably estopped from denying application of an arbitration clause to the fraud claim against the agents of the franchisor.

The franchisee filed a lawsuit for fraudulent inducement against individuals who sold him the franchise in violation of the Illinois Franchise Disclosure Act, the Illinois Consumer Fraud and Deceptive Business Practices Act and common law causes of action. The defendants filed a motion to dismiss or stay pending arbitration. The motion was initially denied because the individual defendants were not parties to the arbitration clause and an issue of fact existed whether the defendants, as nonsignatories to the franchise agreement, could compel arbitration in their representative capacity.

After deposition, defendants filed a renewed motion to compel arbitration or dismiss, claiming that the plaintiff's claims were so intertwined with the franchise agreement, and that they were obviously acting as agents for the franchisor, that it was immaterial that they were not signatories. In support of this renewed motion, the defendants attached the transcript where the franchisee testified that he knew he was buying the franchise from the franchisor, not signing a franchise agreement with the

defendants personally, and that the franchisee knew the defendant was always working for the franchisor. In addition, the defendants submitted an affidavit that all contacts with the franchisee were in the capacity of the director of franchise development and that all emails contained that representative title. The trial court dismissed the complaint.

Expect to see arbitration clauses to be used more and more offensively to include nonsignatories to an arbitration so as to advance the goals of speedy and efficient alternative dispute resolution.

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