

The Shortcoming of Arbitration in the Modern World: the Third Parties Limitation

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ABSTRACT: Arbitration offers a unique and practical tool for solving private disputes between commercial parties. International commercial arbitration has traditionally been considered a creature of consent. Generally, arbitration is only able to compel willing parties, or those privy to the contract, to arbitrate. Therefore, arbitral tribunals have been unwilling to entertain claims by a non-signatory to arbitrate which leads some critics to consider the lack of extension to third parties a major short-coming of arbitration in the modern world. This paper concludes that the general consensus has become increasingly more willing to extend the arbitration agreement to third parties who were not signatories of the main contract. This conclusion is drawn from recent case law and amendments to the UNCITRAL Model Law on International Commercial Arbitration. The paper also highlights the utilisation of common law principles derived from agency and contract law as a means of facilitating a more inclusive approach from arbitral tribunals, with heavy focus on the five common theories first identified in the Thomson case and their further development in later cases.

Keywords: international commercial arbitration, third-party problem, commercial law.

Introduction

Within the legal world, arbitration offers a unique and practical tool for resolving private disputes between commercial parties.¹ Traditionally, consent is considered the most essential characteristic within arbitration disputes.² A potential major benefit of arbitration, therefore, is that it is chosen consensually by contracting parties.³ Arbitration can then best be described as a “creature of consent not coercion.”⁴ Furthermore, the preservation of legal certainty and the res judicata are also fundamentally important within arbitration and therefore the extension of the res judicata lies at the heart of the third party problem, as the preservation of a decision’s authority alongside maintaining legal certainty are tantamount to upholding the rule of law.

Arbitration purports to only compel willing parties to arbitrate, or parties that are privy to the contract. Therefore, only those parties within the agreement can generally be

1 Margaret L. Moses, *The Principles And Practice Of International Commercial Arbitration* (Cambridge University Press 2010), 32.

2 Ibid.

3 Richard Bamforth, et al. “Joining non-signatories to an arbitration: recent developments,” *The In-House Perspective* 3, no. 3 (2007): 17-24.

4 *Volt Informational Sciences, Inc., v. Stanford*, 489 U.S. 468, 479 (1989)

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obliged to arbitrate, or in converse, those outside of the arbitration should not be able to compel signatories within the contract to arbitrate.⁵ Until recently arbitral tribunals would not entertain any claim by a non-signatory to arbitrate,⁶ leading critics to suggest that one of the major limitations of arbitration is that it is unable to be extended to include non-signatory third parties. As a consequence of globalization and the international nature of companies and commercial transactions in recent years, the issue of third parties within commercial arbitration has become increasingly important.

This paper aims to tackle the third party problem within international commercial arbitration. Traditionally, a company that had not signed the arbitration agreement in writing would be unable to arbitrate. However, this paper proposes that this is no longer the case. Recent case law suggests arbitral tribunals are more and more likely to extend the arbitration agreement to third parties who were not signatories of the main contract. Furthermore, recent changes to the UNCITRAL Model Law on International Commercial Arbitration⁷ effecting the New York Convention⁸ demonstrate a shift towards a more inclusive approach focusing more on the substance of the circumstances, rather than the formal written requirements.⁹ To achieve this goal, tribunals and courts have borrowed principles from contract and agency, as well as utilized doctrines from other areas of law to help facilitate the process.¹⁰ However, because of the international nature of commercial arbitration, problems with certainty and uniformity arise. This paper aims to highlight the common principles and theories which allow the extension of the arbitration agreement to third parties, through recent case law and tribunal decisions.

This paper first explores the contextual background of the third party problem. The consensual nature of arbitration will be considered, alongside the importance of the arbitration agreement. The section titled ‘Third Party Problem’ will also attempt to define the term third party non-signatories for the purpose of this paper, before considering the theoretical and practical implications surrounding the extension of the arbitration agreement. After establishing the relevant background information, the section titled ‘extending the arbitration agreement’ will consider the five common theories first identified in the case of Thomson¹¹: Incorporation by reference, assumption, agency, estoppel and alter ego. As well, as the “group of companies doctrine” created in the case

5 Marcia Ashong, “International arbitration agreements and non-signatories: The challenges going forward for the globalised petroleum industry” University of Dundee, Centre for energy Petroleum and Mineral law policy, accessed January 3, 2015, www.dundee.ac.uk/cepmlp/gateway/files.php.

6 *Ibid.*, 2.

7 UNCITRAL Model Law on International Commercial Arbitration (1985).

8 The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, New York.

9 James M. Hosking, “The Third Party Non-Signatory’s Ability to Compel International Commercial Arbitration: Doing Justice Without Destroying Consent,” *Pepperdine Dispute Resolution Law Journal* 4, no. 3 (2004), 480.

10 *Ibid.*, 481.

11 *Thomson-CSF S.A. v. Am. Arb. Ass’n*, 64 F.3d 773, 776 (2d Cir. 1995).

of Dow Chemical.¹² This section will also highlight any common themes present between the theories. In the final section, this paper will consider the recent changes in the laws governing arbitration, although due to word constraints, will only offer a brief overview.

The ‘Third Party Problem’

This section of the paper aims to develop an understanding of the principles behind the extension of the arbitration agreement to include third party non-signatories. Beginning with an overview of arbitration as a whole, this section will subsequently consider in more detail, the importance of consent, the arbitration agreement and the definition of a third party non-signatory within the remit of this paper. Finally, this section will consider the reasoning behind the shift to a more inclusive approach towards third parties, while considering the consequential theoretical and practical implications.

Consent: the Heart of Arbitration

Arbitration offers a private form of dispute resolution, in which parties are able to settle their disputes through an arbitration tribunal, rather than pursue a claim through the court system.¹³ There are numerous benefits in utilizing arbitration to settle commercial disputes.¹⁴ Arbitration offers an autonomous, efficient and a relatively cost-effective alternative to litigation in the courts.¹⁵ The parties can agree on almost every aspect of the process, from the nationality of the arbitrations, to the location of the proceedings in a neutral country and language.¹⁶ Furthermore, the parties are able to ensure the award will be enforced through the New York Convention, which is upheld through its ratification in the vast majority of countries.¹⁷ The popularity of arbitration in recent years is often assigned to the rising number of international commercial transactions.¹⁸ Arbitration offers a solution to companies looking for certainty, as its potential for bespoke provisions and uniform enforcement offers a helpful place to solve difficult international contractual disputes between parties.¹⁹

In choosing arbitration, the parties voluntarily waive their rights to pursue litigation in the court systems.²⁰ “Litigation is a fundamental, inherent right granted to all legal entities, and in essence, arbitration is a deprivation of this fundamental right.”²¹ Therefore,

12 Dow Chemical v Isover Saint Gobain ICC No. 4131/1982

13 Moses, *The Principles And Practice Of International Commercial Arbitration*, 33.

14 Ibid.

15 Ibid., 34.

16 Nigel Blackaby et al., *Redfern and Hunter on International Commercial Arbitration* (5th edn, Oxford University Press, 2009), 101.

17 The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958

18 Nigel Blackaby et al., *Redfern and Hunter on International Commercial Arbitration*, 24.

19 Ibid., 25.

20 Moses, *The Principles And Practice Of International Commercial Arbitration*, 34.

21 Clint A. Corrie, “Challenges in International Arbitration for Non-Signatories,” *Comparative Law Yearbook of International Business* 29 (2007): 45-74.

where a dispute is submitted to arbitration, it must be entirely clear that the parties are aware of their rights, and have willfully agreed.²² Consequently, many commentators consider consent is the fundamental premise on which arbitration is based.²³ Some have even suggested “like consummated romance, arbitration rests on consent.”²⁴ To determine whether there is consent between the parties, courts and tribunals have traditionally considered whether there is an agreement to arbitrate between the parties.²⁵

The Arbitration Agreement

Generally, parties will express their consent to submit to arbitration to settle any future dispute through an arbitration agreement.²⁶ This arbitration agreement is normally included during the formation of the contract between the parties.²⁷ Within the arbitration agreement, the parties stipulate the provisions from which they hope to settle any future disputes arising from the contract. “In essence, the parties create their own private justice system.”²⁸ Generally, the arbitration agreement is considered in isolation from the rest of the contract.²⁹ The doctrine of separability grants the arbitration agreement autonomy “from the underlying contract in which it appears.”³⁰

The arbitration agreement represents the relinquishment of the right to have the dispute resolved judicially.³¹ As previously stated, arbitration is a “matter of consent not coercion.”³² Unless the two parties have agreed to arbitrate, they should not otherwise be compelled to do so. Therefore, the arbitration agreement is of the utmost importance. To determine whether the parties have actually consented to arbitrate, national laws as well as the New York Convention state certain requirements for the arbitration agreement to be valid³³. Traditionally, the arbitration agreement will be in writing and signed by both parties³⁴. The rigidity of the New York Convention and in the past the UNCITRAL Model Law on International Commercial Arbitration demonstrate the paramount importance of consent to the arbitral procedure³⁵.

In recent years following the growing trend of international commercial transactions

22 Ibid., 55.

23 Ibid.

24 William W. Park, “Non-Signatories and International Contracts: An Arbitrator’s Dilemma,” *The Leading Arbitrators’ Guide to International Arbitration*, accessed January 3, 2015, http://events.whitecase.com/people/akomninos/International_Dispute_Resolution_Newsletter_June_06.pdf.

25 Moses, *The Principles And Practice Of International Commercial Arbitration*, 37.

26 Moses, *The Principles And Practice Of International Commercial Arbitration*, 37.

27 Tae Courtney, “Binding Non-Signatories to International Arbitration Agreements: Raising Fundamental Concerns in the United States and Abroad,” *Rich. J. Global L. & Bus.* 8 (2008): 581.

28 Moses, *The Principles And Practice Of International Commercial Arbitration*, 36.

29 Ibid.

30 *Peterson Farms Inc v C&M Farming Ld* [2004] All E.R. (D) 50.

31 Moses, *The Principles And Practice Of International Commercial Arbitration*, 36.

32 Edward Ho Ming Tang, “Methods to extend the scope of arbitration to third party non-signatories,” (2009) Hong Kong School of Law, Research Paper.

33 New York Convention Article II.

34 New York Convention Article II(II).

35 Tang, “Methods to extend the scope of arbitration to third party non-signatories,” 56.

and technological advances, contracts are more often completed orally or in non-traditional means.³⁶ Consequently, public opinion has shifted towards promoting a less rigid approach to the formal writing requirement under the New York Convention.³⁷ Promoting a harmonious interpretation of any amendment to the international convention would be difficult, as there are over 145 contracting states under the New York Convention.³⁸ To rectify this issue, the UNCITRAL Model Law on Arbitration revised Article VII of the act. Recommending that Article II of the New York Convention should recognize “the circumstances described therein are not exhaustive.”³⁹ Nevertheless, courts still have justified reservations about requiring a party to arbitrate, if it appears that the party did not agree to do so.⁴⁰ The importance of the changes to Model Law will be further considered in the section titled ‘Institutional rules, Laws and Conventions dealing with third parties’.

Third Parties and Non-signatories

At this juncture it would be important to distinguish between a non-signatory and a third party. A non-signatory is someone who has not physically signed the agreement within which the arbitration clause is contained.⁴¹ The term non-signatory is potentially misleading as it implies a signature is necessary to complete an arbitration agreement, however as previously discussed this is no longer a necessity as many courts and tribunals will accept an agreement to arbitrate that has not been signed.⁴² The term “third party” is used to refer to someone who is not a named party in such an agreement. Generally a third party will also be a non-signatory.

Practical Issues With Extending the Arbitration Clause

Extending the arbitration clause to include third party non-signatories is often referred to as one of the most contentious issues within international commercial arbitration.⁴³ The rigidity of the courts in the past to extend the arbitration agreement to third parties, has been criticized as the most significant shortcoming of modern commercial arbitration. However, binding parties outside of the arbitration agreement is not without consequence. Extending the arbitration agreement imposes a duty outside of those who have agreed to arbitrate.⁴⁴ Therefore, extending the arbitration agreement could be considered at a juxtaposition to the consensual nature at the heart of arbitration.⁴⁵ Yet a balance must

36 Moses, *The Principles And Practice Of International Commercial Arbitration*, 37.

37 Ibid.

38 Ibid.

39 UNCITRAL Model Law on Arbitration Article 7 .

40 Gregson v. Creative Artists Agency, 210 F.3d 524, 528 (5th Circuit, 2000).

41 Hosking, “The Third Party Non-Signatory’s Ability to Compel International Commercial Arbitration,” 480.

42 Moses, *The Principles And Practice Of International Commercial Arbitration*, 35.

43 Hosking, “The Third Party Non-Signatory’s Ability to Compel International Commercial Arbitration,” 480.

44 Park, “Non-Signatories and International Contracts: An Arbitrator’s Dilemma,”322.

45 Ibid.

be reached between consent and the maximization of the practical effectiveness of the arbitration award.⁴⁶

Extending the arbitration agreement becomes complicated because any extension to third parties is not currently governed by any international treaties on arbitration, such as the Model law or the New York Convention.⁴⁷ Consequently, any attempt by a court or tribunal to extend the arbitration agreement to a third party may potentially face issues, once the award has been rendered, and may be potentially set aside by a national court or refused recognition and enforcement.⁴⁸ As a result, commercial parties may be deterred from arbitration as it could lack legal certainty.

In recent years following the growing trend of complex international commercial transactions, where the “true” party to the dispute is initially unclear, courts and tribunals are more frequently extending the arbitration agreement to be more inclusive of third parties.⁴⁹ However, unsurprisingly this has not been completed in a uniform manner, with jurisdictions adopting different approaches to deal with this issue. To demonstrate how arbitration has become more accommodating to the notion of extension or joinder, the next section of this essay attempts to examine the different theories and principles used by the courts and tribunals.

Extending the Arbitration Agreement

This section will consider recent arbitral precedent and case law to explore the different methods in which an arbitration agreement can be extended to include third party non-signatories. As previously discussed, there is currently no uniform approach offered by either the New York Convention or the UNCITRAL Model Law in regards to extending the arbitration agreement. However, the amount of cases involving the extension of the arbitration agreement in recent years has risen drastically.⁵⁰ As a result, there is a substantial body of jurisprudence available to help identify the common themes between the different approaches taken to join non-signatory third parties.⁵¹

When can the Arbitration Agreement be Extended?

Consent, as already established, is essential to the arbitral process. The courts have therefore asserted that “arbitration agreements applies to non-signatories only in rare circumstances.”⁵² However, in recent years there is a growing trend among tribunals

46 Ibid.

47 Corrie, “Challenges in International Arbitration for Non-Signatories,” 45.

48 Ibid.

49 Tang, “Methods to extend the scope of arbitration to third party non-signatories.”

50 Corrie, “Challenges in International Arbitration for Non-Signatories,” 45.

51 Ibid., 46-47.

52 *The Rice Company (Suisse), S.A. v. Precious Flowers Ltd.* 523 F. 3d 528, 536 (5th Cir. 2008), *citing* *Bridas SAPIC v Turkmenistan*, 345 F.3d 347, 358 (5th Cir.2003).

and courts to extend the obligation to arbitrate to non-signatories.⁵³ The most common occurrence of issues surrounding third parties to the arbitration is the binding of a parent company to an agreement made by its subsidiary.⁵⁴ Another common example is when a company or another entity appears to be state controlled.⁵⁵

Generally, express or implied consent is required to arbitrate. If there is a lack of an express agreement, the courts will consider the conduct of the parties to determine whether the parties displayed implied consent.⁵⁶ The courts have taken many different approaches to determining whether there is implied consent from the parties.⁵⁷ The court in *Thomson* identified five principles under which a non-signatory may be compelled to arbitrate: incorporation by reference, assumption by obligation, agency, veil-piercing (alter ego/group of companies) and estoppel.⁵⁸ Other doctrines which have been utilized to bind non-signatories include *inter alia* guarantee, assignment, succession, novation and third party beneficiary.⁵⁹ The following subsections of this essay will attempt to examine some of these theories to extract any common themes in conjunction with recent arbitral precedent.

Incorporation by Reference

Utilizing contractual principles, non-signatories have been compelled to arbitrate when they are parties to a contract that either incorporates the arbitral agreement into their agreement, or the arbitral agreement incorporates the non-signatory by reference.⁶⁰ The underlying principle of binding non-signatories through incorporation by reference relates back to the previously discussed notion of consent.⁶¹

This approach was identified in *Thomson*⁶² and courts have for a long time accepted incorporation by reference as a process by which non-signatories are able to be bound.⁶³ However, the courts have taken different approaches in applying this theory. In the case of *Import Export Steel Corp. v Mississippi Valley Barge Line Co.*,⁶⁴ a bill of lading was executed, which directly incorporated by reference other agreement between the parties that included mandatory arbitration clauses. One of the parties attempted to claim it was

53 Carolyn B. Lamm and Jocelyn A. Aqua, "Defining the Party-Who Is a Proper Party in an International Arbitration Before the American Arbitration Association and Other International Institutions," *Geo. Wash. Int'l L. Rev.* 34 (2002): 711.

54 Moses, *The Principles And Practice Of International Commercial Arbitration*, 36.

55 *Dallah Real Estate and Tourism Holding Company v. Ministry of Religious Affairs, Government of Pakistan* [2010], UKSC 46 (Nov, 3 2010)

56 *Ibid.*, 36-37.

57 Tae, "Binding Non-Signatories to International Arbitration Agreements," 44.

58 *Thomson-CSF S.A. v. Am. Arb. Ass'n*, 64 F.3d (2d Cir. 1995), 776.

59 Nigel Blackaby et al., *Redfern and Hunter on International Commercial Arbitration*, 122.

60 Moses, *The Principles And Practice Of International Commercial Arbitration*, 33.

61 Bamforth et al., "Joining non-signatories to an arbitration," 20.

62 *Thomson-CSF S.A. v. Am. Arb. Ass'n*, 64 F.3d (2d Cir. 1995).

63 Jeffrey MacHarg and Albert Bates, "Non-Signatories and International Arbitration: Understanding the Paradox," *Comparative Law Yearbook of International Business* 29 (2007): 3-22.

64 *Import Export Steel Corp. v Mississippi Valley Barge Line Co.*, 351 F.2d 505 (2d Cir., 1965).

not compelled to arbitrate, as it had not signed the arbitration clause.⁶⁵ The courts however, found that the party had conveyed its intent to be bound, as it had signed an agreement expressly incorporating another which included an arbitration agreement.⁶⁶

Within the UK, issues have arisen on whether there is a necessity to explicitly reference the arbitration agreement, for incorporation by reference to be applicable.⁶⁷ US case law offers some insight on the matter. In the case of *Grundstad v Ritt*, the seventh circuit found there was no express intention of the parties to be bound by arbitration, as there was no explicit reference in the other documents to the arbitration clause.⁶⁸ *Grundstad* demonstrates the intention of the parties is vital in determining whether to bind a third party and re-emphasizes the importance of consent to arbitration. However, the courts demonstrated a more lenient approach in *Weatherguard Roofing, Co v D. R. Ward Constr. Co.*⁶⁹ The decision of the courts rested on the language used by the parties within the subcontract and found that it demonstrated enough intention to apply incorporation by reference.⁷⁰ Therefore it is possible to surmise, that in deciding upon whether to invoke the theory of incorporation by reference the courts will rest primarily on the intentions of the parties.

Agency

The doctrine of agency may also be invoked to extend the arbitration agreement to bind a third party.⁷¹ There is a unanimous acceptance from courts and tribunals that agency principles are applicable within arbitration.⁷² However, the application has differed between jurisdictions. Therefore it is important to consider the different jurisdictional approaches in conjunction with the issues that arise through applying agency principles.

Agency can be defined as a “fiduciary relationship created by an express or implied contract or by law, in which one party (the agent) acts on behalf of another party (the principal) and binds the other party by words or actions.”⁷³ The most frequent, occurring form of this relationship, is a representative of a company signing an arbitration agreement on its company’s behalf.⁷⁴ Therefore, the arbitration agreement concluded by the agent would effectively bind the principal in any future dispute.⁷⁵ Whether the agent is also bound to arbitrate is dependent on whether the principal was disclosed or undisclosed at

⁶⁵ *Ibid.*, 352.

⁶⁶ *Ibid.*, 352.

⁶⁷ *Aughton Ltd v M.F. Kent Service Ltd* (1991) 57 B.L.R.

⁶⁸ *Grundstat v Ritt* 106 F.3d 201 (1997).

⁶⁹ *Weatherguard Roofing Co v D.R. Ward Construction Co.* 152 P.3d 1227 (Ariz. Ct. App. 2007).

⁷⁰ *Ibid.*, 1229.

⁷¹ *Thomson-CSF S.A. v. Am. Arb. Ass’n*, 64 F.3d (2d Cir. 1995).

⁷² James J Senter, “Who is bound by arbitration agreements? Enforcement by and against non-signatories” *International Business Law Review* 55, no.6(2005): 57-59.

⁷³ Black’s Law Dictionary, 7th ed., s.v “Agency.”

⁷⁴ UNIDROIT Principles of International Commercial Contracts 2010 Article 2.2.3.

⁷⁵ Fouchard, Philippe et al. *Fouchard, Gaillard, Goldman on International Commercial Arbitration* (The Hague; Boston: Kluwer Law International, 1999), 330.

the time the contract was entered into. An agent for a disclosed principal is generally not bound to the contract.⁷⁶

When invoking agency principles to bind a principal, issues arise dependent on the authority of the agent. An agent's authority depends on whether the relationship was demonstrated through "written, or spoken words, or conduct, by the principal, communicated either to the agent (actual authority) or the third party (apparent authority)."⁷⁷

Actual authority requires the agent to have acted within the scope of their power to bind the principal.⁷⁸ In Germany and France, there are no requirements for the principal to have granted the agent power in any particular form.⁷⁹ In contrast, Swiss law dictates that the principal must expressly authorize the agent to sign any arbitration agreement.⁸⁰ Austrian law adopts an even stricter approach, requiring the authorization to be in writing.⁸¹

In certain circumstances, a principal may also be bound, if the agent had "apparent authority."⁸² Unlike actual authority, it is the impression made by the principal to the third party, which is of the utmost importance.⁸³ The principal must have induced the third party into believing the agent had authority to act on his behalf.⁸⁴

Interocean Cayman Co. demonstrated the importance of the facts of the case in determining whether the principal had induced a third party.⁸⁵ This paper proposes that the utilization of agency theory to bind the principals of agents facilitates the maximization of the practical effectiveness of any award rendered, without necessarily threatening the consensual heart of arbitration.

Assumption

A further theory used to bind third parties is assumption, inferring consent from the conduct of the parties.⁸⁶ To extend the arbitration agreement to bind a non-signatory under assumption, there is a requirement of conduct demonstrating an intent to be bound by the assumed arbitral agreement.⁸⁷ The necessity for intent was highlighted in *Caribbean SS. Co., SA v Sonmez Denizcilik Ve Ticaret AS*.⁸⁸ Within this case the third party was not required to arbitrate because he had no intention of being bound by the arbitration clause.⁸⁹ Furthermore, in *Thomson*, the recent purchasing of a subsidiary did not manifest

76 Senter, 57.

77 *Hester Inter. Corp. v Federal Republic of Nigeria*, 879 F.2d 170, 181 (5th Circuit 1989).

78 *Bridas S.A.P.I.C. v Turkmenistan*, 345 F.3d 347, 358 (5th Circuit 2003).

79 Tang, "Methods to extend the scope of arbitration to third party non-signatories," 87.

80 *Ibid.*

81 Moses, *The Principles And Practice Of International Commercial Arbitration*, 34.

82 *Ibid.*, 34.

83 *Bridas S.A.P.I.C. v Turkmenistan*, 345 F.3d 347, 358 (5th Circuit 2003).

84 *Ibid.*, 370.

85 *Interocean Shipping Co. v. National Shipping and Trading Corp. and Hellenic International Shipping*, S.A., 523 F.2d 527 (2nd Circuit 1975).

86 Bamforth, "Joining non-signatories to an arbitration," 334.

87 Corrie, "Challenges in International Arbitration for Non-Signatories," 123.

88 *Caribbean SS. Co., SA vs. Sonmez Denizcilik Ve Ticaret AS*, 598 F.2d 1264 (2^d Cir., 1979).

89 *Ibid.*, 610.

an intention of the parent company to be bound by the obligations of its subsidiary. If a third party's conduct could be construed to have waived any objection to being bound to arbitration, the theory of assumptions will also apply compelling the third party to arbitrate.⁹⁰

The rationale behind invoking the principles of assumption is to avoid non-signatories expressing intent to arbitrate, before subsequently asserting the arbitral award is invalid.⁹¹ Similar to agency theory, the intention of the parties is paramount in determining whether the arbitration agreement should be extended to a third party.

Piercing the Veil and the Doctrine of Alter Ego

Traditionally, a corporate relationship between two companies, would not bind a non-signatory to an arbitration agreement.⁹² Courts are also reluctant to pierce the corporate veil and hold one corporation legally accountable for the actions of another.⁹³ However, when a relationship is so close between a parent company and its subsidiary then the courts will no longer view them as separate legal entities, but consider one "the alter ego" of the other.⁹⁴ When this occurs, the signing of an arbitration agreement by one party, will essentially bind the other. This doctrine may also be interpreted to bind governments to state-owned enterprises in a similar manner.⁹⁵

It is important at this juncture to distinguish the principles of agency theory and the doctrine of alter ego. In *House of Koscot v American Line Cosmetics*, the courts applied the two theories as if they were interchangeable.⁹⁶ However, the theories derive their applicability from different sources.⁹⁷ Agency theory is based on contractual principles, whereas the alter ego doctrine is based on the notion of equity.⁹⁸ Therefore, regardless of the agreements structure, under the alter ego doctrine, a third party may still be compelled to arbitrate.⁹⁹

Piercing the corporate veil is not a common occurrence, however on the rare occasion when two affiliated entities demonstrate a corporate relationship that is so close, they may effectively lose their distinct judicial identities.¹⁰⁰ The courts consider a variety of factors in determining whether to apply the alter ego doctrine.¹⁰¹ The case of *Bridas S.A.P.I.C v Government of Turkmenistan*, found that the alter ego doctrine applies when the parent

⁹⁰ Tae, "Binding Non-Signatories to International Arbitration Agreements," 123.

⁹¹ Ibid, 123.

⁹² Moses, *The Principles And Practice Of International Commercial Arbitration*, 34.

⁹³ Hosking, "The Third Party Non-Signatory's Ability to Compel International Commercial Arbitration," 110.

⁹⁴ Moses, *The Principles And Practice Of International Commercial Arbitration*, 35.

⁹⁵ Ibid., 35.

⁹⁶ *House of Koscot Dev't Corp. vs. American Line Cosmetics, Inc.*, 468 F.2d 64 (5th Cir., 1972).

⁹⁷ Corrie, "Challenges in International Arbitration for Non-Signatories," 190.

⁹⁸ *Harell v DCS Equip Leasing Corp.*, 951 F.2d 1453, 1458 (5th Circuit, 1992).

⁹⁹ Thomson); Corrie, "Challenges in International Arbitration for Non-Signatories," 191.

¹⁰⁰ Thomson; Moses, *The Principles And Practice Of International Commercial Arbitration*, 32.

¹⁰¹ Corrie, "Challenges in International Arbitration for Non-Signatories," 191.

company completely controls the subsidiary and “commits a fraud or wrong that injured the party seeking to pierce the corporate veil.”¹⁰² The notion of control and dominance of the parent over the subsidiary was further emphasized in the Second Circuit case of *Gartner v Snyder*.¹⁰³ Unlike the previously discussed contractual theories of incorporation by reference, agency and assumption, the alter ego doctrine draws from the economic relationship between the parties involved, to reach a fair and just result.¹⁰⁴

The Group of Companies Doctrine

The “group of companies doctrine” attempts to compel affiliated companies, not of all which are signatories to a particular contract that contains an arbitration clause.¹⁰⁵ The rationale behind the doctrine supports the notions of equity and maximizing the effectiveness of any rendered award, by ensuring the correct party is bound to arbitration.¹⁰⁶ Under the “group of companies doctrine,” provided any non-signatory was in some way involved in the performance, termination or conclusion of the agreement, then they may be compelled to arbitrate.¹⁰⁷ However, as demonstrated in the other theories discussed, the presence of intent or consent to arbitrate remains an absolute necessity.¹⁰⁸

The doctrine was first introduced in *Dow Chemical v Isovex Saint Gobain*.¹⁰⁹ The case involved a claim being brought by a parent company and a second subsidiary, in addition to the parties which had signed the arbitration agreement.¹¹⁰ Despite technically being separate entities, the tribunal considered the companies of “one and the same economic reality”¹¹¹ and therefore extended the arbitration agreement to include all of the parties.¹¹² The tribunal cited the importance of the two previously discussed requirements of, participation and intention.¹¹³

Globally, the use of the doctrine has been both limited and contentious.¹¹⁴ Commentators consider the doctrine ambiguous and insufficiently grounded in legal reasoning to bind a non-signatory.¹¹⁵ Many states including the US prefer the use of more traditional theories,

102 *Bridas; Moses, The Principles And Practice Of International Commercial Arbitration*, 32.

103 *Gartner v. Snyder*, 607 F.2s 582, 586 (2nd Circuit. 1979); Tang, “Methods to extend the scope of arbitration to third party non-signatories,” 19.

104 Corrie, “Challenges in International Arbitration for Non-Signatories,” 192.

105 *Moses, The Principles And Practice Of International Commercial Arbitration*, 32.

106 *Stavros L. Brekoulakis, Third Parties in International Commercial Arbitration*, Oxford International Arbitration Series (New York: Oxford University Press, 2010), 85.

107 *Stephan Wilske, Laurence Shore, and Jan-Michael Ahrens, “The ‘Group of Companies Doctrine’—Where Is It Heading?,” Am. Rev. Int’l Arb.* 17 (2006): 74.

108 *Bamforth, “Joining non-signatories to an arbitration,”* 444.

109 *Dow Chemical v Isovex Saint Gobain ICC No. 4131/1982* .

110 *Blackaby et al., Redfern and Hunter on International Commercial Arbitration*, 101.

111 *Mohit Saraf and Luthra & Luthra: “Who is a party to an arbitration agreement - Case of the non-signatory” Institutional Arbitration in Asia [2007].*

112 Tang, “Methods to extend the scope of arbitration to third party non-signatories,” 77.

113 *Ibid.*

114 *Ibid.*, 78.

115 *Blackaby et al., Redfern and Hunter on International Commercial Arbitration*, 102 cited in *Moses, The Principles And Practice Of International Commercial Arbitration*, 38.

such as estoppel or the alter ego doctrine.¹¹⁶ The English courts have taken a rigid stance on the application of the “group of companies” doctrine.¹¹⁷ Initially in *Capara group Ltd v Fagor Arrastate Sociedad Cooperativa*¹¹⁸ and later in *Peterson Farms Inc v C&M Farming Ltd*¹¹⁹ the English courts adopted a narrow approach, asserting the doctrine was non-existent under English law.¹²⁰ The Swiss courts have also followed a similar approach to England.¹²¹

Equitable Estoppel

Generally, the concept of equitable estoppel is applied most frequently to parties within the US.¹²² The doctrine of equitable estoppel represents the extension of the arbitration agreement to create a right based on conduct which resembles the undertaking of contractual obligations.¹²³ The doctrine was recently explained in *Meyer v WMCO-GP L.L.C.*¹²⁴ In this case the court stated that any “person (including a non-signatory) claiming a benefit from a contract containing an arbitration agreement is equitably estopped from refusing to arbitrate.”¹²⁵ The rationale behind estoppel in arbitration was highlighted in *Grigson*, where estoppel was invoked to prevent the signatory plaintiff having it both ways.¹²⁶

Alternatively estoppel may also be utilised to bind a third party following by intertwined issues.¹²⁷ A signatory to a contract including an arbitration agreement will be estopped from refusing arbitration to a non-signatory, when allegations are raised of substantial interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract.¹²⁸

Estoppel has been considered to offer “a potential alternative” to the requirement of consent, as the foundation for binding a non-signatory, although, this notion is strongly criticised.¹²⁹ Nevertheless, the doctrines of estoppel, alter ego and group of companies all share one common element. The application of the doctrines are essential, as if only the formal requirements for binding a party to an arbitration agreement were applied, then justice would not be served.¹³⁰

116 Moses, *The Principles And Practice Of International Commercial Arbitration*, 38.

117 *Caparo Group Ltd v Fagor Arrastate Sociedad Cooperativa* Commercial Court, QBD, 7th August 1998; *Peterson Farms Inc v C&M Farming Ld* [2004] All E.R. (D) 50.

118 *Ibid.*, 50.

119 *Ibid.*, 110.

120 *Ibid.*, 100.

121 Blackaby et al., *Redfern and Hunter on International Commercial Arbitration*, 102.

122 Moses, *The Principles And Practice Of International Commercial Arbitration*, 37.

123 Bamforth, “Joining non-signatories to an arbitration,” 330.

124 *Meyer v WMCO-GP L.L.C.*, 211 S.W.3d 302, 305 (Tex. 2006).

125 *Ibid.*, 310.

126 *Grigson vs. Creative Artists Agency, LLC*, 210 F.3d 528 (5th Cir., 2000); Corrie, “Challenges in International Arbitration for Non-Signatories.”

127 Moses, *The Principles And Practice Of International Commercial Arbitration*, 37.

128 Meyer, 401.

129 Bamforth, “Joining non-signatories to an arbitration,” 331.

130 *Ibid.*, 331.

Institutional Rules, Laws and Conventions Dealing With Third Parties

In the previous section, the theories and principles which govern when an arbitration agreement is able to be extended to a third party non-signatory were discussed. However, international arbitration is governed by a wide variety of regulations dependent on the arbitration agreement of the parties. Therefore, it is necessary to consider how regulatory bodies deal with this issue.

The New York Convention is of the utmost importance in enforcing foreign arbitration awards, as it is ratified by other 145 states.¹³¹ Therefore, any arbitration award must ensure that it adheres to the terms of the convention to ensure it is able to be upheld.¹³² Previously, this paper discussed the writing requirement set out in Article II of the Convention. However, recent changes to the UNCITRAL Model Law demonstrate a potential trend towards leniency in regards to the formal writing requirement, Article VII states “recognizing that the circumstances described therein are not exhaustive”. Recent academic commentary have also suggested that the form requirement, is being “liberally applied.”¹³³ Further, Article 7(I)’s “more favourable right” provision, allows any party who is attempting to enforce an award or an arbitration agreement to take advantage of the local laws of the enforcing jurisdiction if it is more favourable to them.¹³⁴

Generally, within the arbitration agreement the parties will stipulate which institutional rules they wish to be governed by.¹³⁵ In recent years, institutional rules which the parties may choose to govern their arbitration have begun to address the issue of binding a non-signatory. For example, the London Court of International Arbitration Rules: Rule 22.1 allows the joining of third parties to an arbitration who have consented in writing to be bound.¹³⁶ Therefore, demonstrating that alongside a mounting body of jurisprudence binding third parties regulatory bodies seem to be moving in the same direction, adapting to increasing complex commercial transactions and situations. Furthermore, as arbitration is a voluntary dispute resolution technique, ensuring the relevant laws are up to date with the current commercial climate, is imperative to ensuring it remains a viable choice to parties.

Conclusion

In the past, courts and tribunals have followed a strict approach in determining who is and is not a party to an arbitration agreement. Pressure from the international business community compelled regulators to make arbitration more accessible to third party non-

131 Hosking, “The Third Party Non-Signatory’s Ability to Compel International Commercial Arbitration,” 135.

132 Corrie, “Challenges in International Arbitration for Non-Signatories,” 187.

133 Hosking, “The Third Party Non-Signatory’s Ability to Compel International Commercial Arbitration,” 134.

134 Moses, *The Principles And Practice Of International Commercial Arbitration*, 34.

135 *Ibid.*, 12.

136 London Court of International Arbitration Rules: Rule 22.1.

signatories, representing the complex nature of international commercial transactions. This paper attempted to argue the extension of the arbitration agreement to third parties is no longer the shortcoming of modern arbitration, but that a strong body of jurisprudence is building up and demonstrating more and more frequently courts and tribunals are willing to join non-signatories. Moreover, recent changes to the UNCITRAL Model Law further demonstrate the willingness in arbitration to permit a little leniency and value substance over form.¹³⁷

The theories discussed were first highlighted in the US case of *Thomson*, with the addition of the “group of companies doctrine.”¹³⁸ It is possible to draw some conclusions from recent arbitral case-law¹³⁹ and to infer some common themes from the theories considered. Extension under contract-based theories, generally link the third party to the signatory of the arbitration agreement (agency or assumption), or to the agreement itself (incorporation by reference). Furthermore, the contract-based theories are generally governed by contractual or agency law. In contrast to the contractual based theories, courts and tribunals using legal doctrines to extend the arbitration agreement, consider the “economic reality” and whether extension would be equitable.¹⁴⁰ The circumstances surrounding the potential applicability of the any doctrinal approach will generally also consider the economic relationship between a signatory and a third party, as well as any derived benefit from the contract.¹⁴¹ Nevertheless, identifying whether the parties “consented to arbitrate” remains vital, regardless of whether doctrinal or contractual theories are applied.¹⁴²

The current trend of allowing third parties to arbitrate more frequently, demonstrates the flexibility of arbitration to facilitate the changing demands of the business community. The ability of arbitration to be able to effectively adapt to the needs of the business community is inherent to its survival, as it is through the commercial sector arbitration was created and as a useful tool in international business that it continues to remain a relevant dispute resolution option.

In regards to the recent changes, it is evident from the arbitral precedent and case law that judges and arbitrators are exhibiting significant caution in throwing open arbitration to non-signatories.¹⁴³ Overall it remains a question of balance, on the one hand, there is a necessity for flexibility to ensure the maximization of the practical effectiveness of the award, while on the other legal certainty and the consent of the parties must remain of paramount importance. Therefore, extending the arbitration agreement to include third party non-signatories, must only occur when it is definitively necessary to do so.

137 Tang, “Methods to extend the scope of arbitration to third party non-signatories,” 370.

138 Thomson.

139 Park, “Non-Signatories and International Contracts: An Arbitrator’s Dilemma,” 120.

140 Ibid., 120.

141 Corrie, “Challenges in International Arbitration for Non-Signatories,” 432.

142 Hosking, “The Third Party Non-Signatory’s Ability to Compel International Commercial Arbitration,” 10.

143 Tang, “Methods to extend the scope of arbitration to third party non-signatories,” 371.

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