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Can Nonsignatory Parties be Compelled to Arbitrate?

Last year the Colorado Supreme Court issued opinions in two cases that involved arbitration clauses: (1) *In re N.A. Rugby Union v. U.S. Rugby Football Union*, 2019 CO 56, 442 P.3d 859 (Colo. 2019); and (2) *Santich v. VCG Holding Corp*., 2019 CO 67, 443 P.3d 62 (Colo. 2019).

Background

A fundamental principle of contract law is that contract formation requires intent by each party to be bound. This article discusses two instances where a "meeting of the minds" did not exist because one party, in each case, was a nonsignatory to the underlying agreement. The first case discusses whether a nonsignatory to an arbitration agreement can be required to arbitrate under that agreement by virtue of the fact that is a purported agent of a signatory to the agreement. The second case discusses whether an arbitration-specific exception to Colorado's traditional equitable estoppel doctrine should be applied.

Colorado state contract law requires an intent to contract by both parties, and generally, only parties to the contract can be required to adhere to provisions of that contract. However, Colorado courts recognize seven exceptions that can be used to compel a non-party to arbitrate under the following limited circumstances: (1) incorporation of an arbitration provision by reference in another agreement; (2) assumption of the arbitration obligation by the nonsignatory; (3) agency; (4) veil-piercing/alter ego; (5) estoppel; (6) successor-in-interest; and (7) third-party beneficiary. The Colorado Court of Appeals in *Meister v. Stout* momentarily deviated from these traditional exceptions by creating an "alternative theory of estoppel" that allowed nonsignatories to be compelled to arbitrate under a new arbitration-specific exception. This new theory did not require a party claiming equitable estoppel to make any showing of detrimental reliance when an arbitration agreement existed. *Meister v. Stout*, 2015 COA 60, 353 P.3d 916, 920-22 (Colo. App. 2015); abrogated by *Santich*, 2019 CO 67, 443 P.3d 62, at 66.

In re N.A. Rugby Union v. U.S. Rugby Football Union

The first case, *North American Rugby Union v. United States Rugby Football Union*, involved a signatory attempting to compel a nonsignatory to arbitrate based on a dispute over a Sanctioning Agreement ("SA"). *In re N.A. Rugby Union v. U.S. Rugby Football Union*, 2019 CO 56, 442 P.3d 859 (Colo. 2019). The Plaintiffs, Douglas Schoninger and N.A. Rugby Union, asserted an array of claims, one of which included a breach of contract claim against the defendant, Rugby International Marketing ("RIM"). RIM moved to dismiss the breach of contract claim on the grounds it was not a party to the contract. The plaintiffs responded by citing an arbitration provision from the SA between them and the U.S. Rugby Football Union that compelled agents of U.S. Rugby (which RIM was) to arbitrate as well. The Plaintiffs argued that RIM is bound by the SA, including the arbitration clause, as a nonsignatory under one or more of the following exceptions: (1) the "third-party" beneficiary exception; (2) the agency exception; or (3) the equitable estoppel exception.

The Colorado Supreme Court disagreed with the plaintiffs and accepted RIM's defense that neither general contract principles nor any of the limited exceptions require them to arbitrate as a nonsignatory. Specifically, the Court held:

1. RIM was not a third-party beneficiary of the SA. Third-party beneficiaries may enforce a contract only if the parties to that contract intended to confer a benefit on the third party ***when contracting***. Here, the SA did not confer specific legal rights on RIM because RIM did not exist at the time the SA was signed.

2. RIM was not bound by the agency exception either. Although RIM was an agent of U.S. Rugby, a principal (U.S. Rugby) cannot bind an agent (RIM).

3. RIM was not bound by the equitable estoppel exception because equitable estoppel can only bind a nonsignatory to an arbitration provision in an agreement when the nonsignatory has knowingly exploited that agreement. Here, RIM did not receive any benefits under the SA. Also, RIM did not assert a claim for rights or benefits under the SA, therefore the equitable estoppel doctrine does not apply.

The Court noted that the Plaintiffs never explained, "how a party to a contract can bind a nonparty to the terms of that contract without establishing legal or equitable grounds for doing so." Furthermore, the court reinforced the general rule that a recognized legal or equitable base must be established by the signatory to compel a nonsignatory to arbitrate.

Santich v. VCG Holding Corp.

The second case, *Santich v. VCG Holding Corporation*, involved a nonsignatory attempting to avoid litigation by compelling a signatory to arbitrate. *Santich v. VCG Holding Corp.*, 2019 COA 67, 443 P.3d 62 (Colo. 2019). In 2017, a group of current and former exotic dancers ("Plaintiffs") brought employment claims against the owners of clubs they performed at and the club owners' parent company. The club-owner defendants used an arbitration clause in their agreement with the Plaintiffs to successfully compel arbitration. The corporate-parent defendant attempted to use the doctrine of equitable estoppel to avoid litigating and compel arbitration with the Plaintiffs.

A federal magistrate judge recommended that the district court accept the club-owner defendant's argument and compel arbitration based on Colorado's "strong policy favoring arbitration agreements." Id at 66. In doing so, the federal magistrate cited *Meister v. Stout*, a Colorado Court of Appeals ruling from 2015 that held "when a signatory to a contract containing an arbitration clause asserts a claim arising from that contract against a defendant who was not a party to the contract, he may be estopped from avoiding arbitration and instead be compelled to arbitrate by and with the nonsignatory defendant." *Meister,* 353 P.3d at 920-22.

The district court requested clarification and the Colorado Supreme Court accepted. The Supreme Court abrogated the Court of Appeal's ruling in *Meister* on the basis it had broken from precedent by endorsing this "alternative theory of estoppel" without sufficient rationale. *Santich*, 443 P.3d 62, at 66. The court found no reason to abandon the traditional requirements for equitable estoppel to create a new arbitration-specific rule. This holding reinforced the long-standing rule in Colorado that requires all four elements of equitable estoppel to be clearly shown for the doctrine to be applied.

Takeaway

Two rules of law can be derived from these Colorado Supreme Court cases regarding arbitration and nonsignatories: (1) Unless a limited exception applies, an arbitration provision in an agreement can only be invoked by and enforced against a signatory to that agreement; and (2) a nonsignatory's claim for equitable estoppel must satisfy all four traditionally defined elements to compel arbitration. The second rule of law also makes clear that holding in *Meister* concerning an alternative theory of estoppel for arbitration-specific cases was poorly reasoned and thus abrogated.

The key takeaway for attorneys drafting arbitration clauses is to consider all parties (including nonsignatories) that the signatories intend to be bound by the arbitration clause and draft the agreement such that the nonsignatories fall within one of the exceptions referenced in this article.