Kluwer Arbitration Blog

Signatory Compelled to Arbitrate Against Non-Signatory: US District Court Influenced by Investment Treaty Jurisprudence

Robert Rothkopf (Herbert Smith Freehills LLP) · Monday, December 22nd, 2014 · Herbert Smith Freehills

The US District Court for the District of Vermont, part of the Second Circuit that also embraces New York and Connecticut, recently compelled a Canadian businessman (Mr. Kastner) to arbitrate his patent dispute against a Swedish footwear company's US subsidiary called Icebug USA ("Icebug"), even though Icebug was not a signatory to the arbitration agreement (*Sidney Kastner v. Vanbestco Scandanavia AB, and Icebug USA, Inc.*, 2014 U.S. Dist. LEXIS 165915).

The case provides a current example of the application of equitable estoppel – one of the theories that US courts have employed to bind non-signatories to arbitration agreements, and by the same token, allow non-signatories to bind a signatory.

The US District Court's decision to compel arbitration between Icebug and Kastner appeared to be influenced by the 2nd Circuit Court of Appeals decision in *Republic of Ecuador v. Chevron*, 638 F.3d, which found consent to arbitration by Chevron under the US-Ecuador BIT had "created a separate binding agreement to arbitrate" even though Chevron had not been party to the BIT. While the concept of "arbitration without privity" is familiar in the investment arbitration context, it is less so in a commercial context. It raises the question as to whether investment treaty jurisprudence might persuade courts to set a lower barrier to establishing consent to arbitration between commercial counterparties.

Patent dispute over studded footwear

Mr. Kastner, doing business under the name Tracktion, holds two US patents for "Resilient, All Surface Soles" allegedly covering footwear with retractable studs. Tracktion and Vanbestco, a Swedish footwear company, had executed a License Agreement that permitted Vanbestco to manufacture and deal in studded footwear falling within the scope of the patents in return for certain royalties. The agreement called for arbitration of all disputes before the International Chamber of Commerce, seated in Montreal, Canada.

When it transpired that the patents were not protected in Norway and Finland, Vanbestco determined that it had been paying royalties for sales in those markets unnecessarily and decided to set-off those amounts against future royalties it owed Tracktion. Kastner claimed that this refusal amounted to a repudiatory breach of the License Agreement, and commenced litigation in Vermont against both Vanbestco and Icebug (Vanbestco's US subsidiary) on the basis that the patent claims

fell outside the scope of the Licence Agreement, and that the repudiation by Vanbestco had also obliterated any obligation to arbitrate the dispute. Vanbestco filed a request for ICC arbitration, and Icebug moved to compel Kastner to arbitrate the dispute.

The US District Court found that the parties' arbitration agreement and reference to the ICC Rules had delegated questions of arbitrability to the tribunal by virtue of Article 6 of the ICC Rules 2012 (applying *Shaw Grp. Inc. v. Triplefine Int'l Corp.*, 322 F.3d 115, 122 (2d Cir. 2003). As such, Kastner's dispute as to the arbitrability of his patent claim was for the arbitrators to decide. The court also dismissed Kastner's submission that Vanbestco's repudiation of the License Agreement had given him "the right to treat the contract as terminated for all purposes of performance" and the right to pursue claims outside arbitration. This was in line with the separability of the arbitration agreement and the survival of the arbitral tribunal's jurisdiction under Article 6(9) of the ICC Rules, regardless of whether the main contract has been terminated.

Compulsion to arbitrate with a non-signatory – BIT-jurisprudence taken out of context?

In deciding the question as to whether Icebug could compel arbitration even as a non-signatory to the arbitration agreement, the court noted that "although Icebug…did not sign the License Agreement, it has consented to arbitrate by seeking arbitration in the pending case. The Second Circuit has recognized that a defendant who was not a party to the original arbitration agreement has 'created a separate binding agreement to arbitrate' the dispute 'by consenting to arbitration", quoting *Republic of Ecuador*, 638 F. 3d at 392 from the 2nd Circuit Court of Appeals. In so doing, the court indicated that Icebug's willingness to arbitrate as a defendant in litigation might create a separate binding arbitration agreement with Kastner.

However, it should be noted that the 2nd Circuit's opinion in Ecuador v Chevron specifically concerned the interpretation of the US-Ecuador BIT. The 2nd Circuit observed that: "At the outset, we note that Chevron is not a party to the BIT. Unlike the more typical scenario where the agreement to arbitrate is contained in an agreement between the parties to the arbitration, here the BIT merely creates a framework through which foreign investors, such as Chevron, can initiate arbitration against parties to the Treaty. In the end, however, this proves to be a distinction without a difference, since Ecuador, by signing the BIT, and Chevron, by consenting to arbitration, have created a separate binding agreement to arbitrate." (638 F. 3d at 392)

Unlike the *Ecuador v. Chevron* case, the Licence Agreement did not provide a standing offer to arbitrate that Icebug could accept. Nevertheless, the case set the context for the court's analysis of Second Circuit decisions in which non-signatories to arbitration agreements had been bound by various mechanisms, such as incorporation by reference, assumption, agency, veil-piercing/alter ego, and estoppel (*Smith/Enron Cogeneration Ltd. P'ship, Inc.*, 198 F. 3d).

Ultimately, the court applied the two part test for equitable estoppel from *Alghanim v. Alghanim*, 828 F. Sup 2d 636, 648 (SDNY 2011):

- First "the relationship among the parties, the contract they signed…, and the issues that had arisen among them must demonstrate that the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed."
- Second "there must be a relationship among the parties of a nature that justifies a conclusion that the party which agreed to arbitrate with another entity should be estopped from denying an obligation to arbitrate a similar dispute with the adversary which is not a party to the arbitration agreement."

The court found that the disputes that Kastner wished to litigate, and which Iceburg wished to arbitrate, were intertwined with the License Agreement containing the arbitration agreement. As such, Kastner was estopped from denying an obligation to arbitrate a similar dispute with Icebug, a non-party to the arbitration agreement.

Conclusion

The US courts take a more flexible approach to binding or benefitting non-signatories to arbitration agreements compared with many other jurisdictions. This is in line with the USA's pro-arbitration federal policy, and can be useful for parties who are closely related to a commercial transaction but are not expressly a party to an arbitration agreement.

However, by referring to a decision of the 2nd Circuit that specifically concerned the interpretation of the US-Ecuador BIT, the US District Court may have blurred the distinction between an arbitration agreement that is created through acceptance of a standing offer to arbitrate in a BIT (the phenomenon of "arbitration without privity"), and an arbitration agreement between two commercial entities where a third party wishes to arbitrate against an original commercial signatory without any equivalent standing offer of arbitration.

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