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COURT PERMITS NONSIGNATORIES TO ENFORCE ARBITRATION AGREEMENTS

(Arthur Andersen v. Carlisle)

The U.S. Supreme Court ruled today that those who are the intended beneficiaries of an arbitration agreement are permitted to enforce the agreement in federal court under the Federal Arbitration Act (FAA), even when they are not among those who signed the agreement. The Court further held that the FAA permits nonsignatories to appeal an adverse district court decision.

The decision in *Arthur Andersen, LLP v. Carlisle* was a victory for the Washington Legal Foundation (WLF), which filed a brief urging the Supreme Court to overturn an appeals court decision that had refused to permit nonsignatories to invoke the FAA. The Supreme Court agreed with WLF that permitting nonsignatories to enforce arbitration agreements is in accord with the federal policy that strongly favors enforcement of agreements to arbitrate disputes. WLF argued that the FAA was intended to further that policy, not (as the appeals court held) to stand as an obstacle to enforcement of contract rights long recognized under the common law.

"This case well illustrates that when parties agree to arbitrate any disputes that may later arise between them, they generally intend the agreement to cover disputes involving others engaged in concerted and substantially interdependent conduct, such as employees of the contracting parties," said WLF Chief Counsel Richard Samp following the High Court's ruling. "There is no reason to believe that Congress, in adopting the FAA, intended to deprive such third parties of a federal forum," Samp said.

The case involved tax shelters marketed to the plaintiffs by an investment advisory firm, Bricolage Capital. The investment management agreement entered into between the plaintiffs and Bricolage included an agreement to arbitrate any disputes. When the tax shelters turned sour, the plaintiffs filed suit in federal court not only against Bricolage but also against Bricolage's accounting and law firms, which had provided advice to Bricolage in setting up the tax shelters. The suit against Bricolage was stayed after it declared bankruptcy, leaving only the accounting and law firms as active defendants.

The defendants filed a motion under § 3 of the FAA, urging that the claims against them be stayed until those claims were arbitrated under the terms of the arbitration agreement entered into with Bricolage. The defendants argued that they were entitled to enforce the agreement under the doctrine of equitable estoppel, a well-established

common law doctrine which state courts have invoked throughout U.S. history to permit an arbitration agreement to be enforced, in appropriate circumstances, even by those who did not sign the agreement.

After the district court denied the motion, the defendants appealed to the U.S. Court of Appeals for the Sixth Circuit in Cincinnati. The appeals court dismissed the appeal, holding that § 16 of the FAA deprived it of jurisdiction to hear FAA appeals by entities that did not sign the underlying arbitration agreement. The appeals court held further that nonsignatories have no rights under the FAA -- they may neither move pursuant to FAA § 3 to stay litigation pending arbitration, nor move pursuant to FAA § 4 to compel arbitration.

In reversing the Sixth Circuit, the Supreme Court agreed with WLF that § 16 unequivocally grants appeals courts jurisdiction to hear interlocutory appeals from denials of motions brought under either § 3 or § 4. The Court explained that by holding otherwise, the Sixth Circuit was confusing the issue of jurisdiction with the underlying issue of whether the initial motion was meritorious.

The Court also held that nothing in either § 3 or § 4 categorically bars nonsignatories from seeking to enforce arbitration agreements in federal court. The Court noted that state common law has long recognized such enforcement rights and held that Congress, when it adopted the FAA, intended that federal courts should look to the common law for guidance with respect to all underlying issues of contract law. Because common law has long recognized the right of nonsignatories to enforce arbitration agreements in appropriate cases, federal courts should permit nonsignatories to avail themselves of FAA procedures when asserting their contractual rights, the Court held. It stated that to hold otherwise would undermine the strong federal policy of favoring arbitration agreements and would consign nonsignatories to years of expensive litigation before being permitted to assert their rights.

The Washington Legal Foundation is a public interest law and policy center with supporters in all 50 States. WLF devotes a significant percentage of its resources to defending and promoting free enterprise, individual rights, and a limited and accountable government. WLF's brief was drafted with the pro bono assistance of Thomas S. Jones, Leon F. DeJulius, and Jean M. Mosites of the Pittsburgh office of the Jones Day law firm.

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For further information, contact WLF Chief Counsel Richard Samp, (202) 588-0302. A copy of WLF's brief is posted on its web site, www.wlf.org.