

# The Transactional Lawyer

A Publication of the Commercial Law Center



## Binding All Relevant Parties to an Agreement to Arbitrate

**Jaxon C. Munns**

A recent Texas court decision<sup>1</sup> illustrates a significant problem that can arise in drafting an arbitration clause: how to ensure that disputes will be handled in a single forum when multiple parties may be involved.

The relevant facts of the case can be summarized as follows. An individual purchased a vehicle on credit and granted a security interest in the vehicle to secure the debt. The security agreement contained an arbitration clause. After default, the secured party instructed a collateral recovery company, with which the secured party had a longstanding service agreement, to repossess the vehicle. The service agreement had no arbitration clause. The collateral recovery company subcontracted with a repossession agent. That subcontract also had no arbitration clause. The debtor allegedly suffered personal injuries during the repossession and brought an action against all three parties, and they filed various cross-claims for indemnity and contribution.

The secured party then filed a motion to compel arbitration. It argued that all of the debtor’s claims arose out of its agreement with the debtor, which included the arbitration clause. The court granted the motion to compel arbitration between the debtor and the secured party but denied the motion with respect to the other claims and parties. The secured party appealed and the court of appeals affirmed. It concluded that the debtor had not agreed to arbitrate claims against the other defendants and that the other defendants had not agreed to arbitrate anything.<sup>1</sup> The court acknowledged that the other defendants might have been acting as the secured party’s agent when conducting the repossession, but nevertheless ruled that this did not matter.<sup>2</sup> As a result,

the secured party now bears the expense of litigating in multiple fora and faces the prospect of inconsistent results.

The court suggested that the secured party could have avoided these problems by simply including an arbitration clause in its contracts with the other defendants.<sup>3</sup> While the court’s ruling that the collateral recovery company and repossession agent were not bound by the arbitration clause might have been correct, its suggested solution is highly questionable. That is because the case involved three interrelated problems with respect to arbitrating all the relevant claims, and the court’s suggestion deals with only one of them.

### Problem One – The Scope of the Arbitration Clause with the Debtor

The mere fact that the debtor has agreed to arbitrate disputes with the secured party does not mean that the debtor has agreed to arbitrate disputes with third parties, even if those disputes arise out of the secured transaction. Whether the debtor has or has not so agreed depends on the language of the arbitration clause. For example, consider the following two arbitration clauses.

**Arbitration. The parties shall arbitrate any claim or dispute between them arising out of this Agreement or relating to the transaction or relationship of the parties created hereby.**

**Arbitration. The parties shall arbitrate any claim or dispute:**

- (i) between them; or**
- (ii) by, against, or with any third party, including an employee, agent, assignee, or independent contractor of either of them,**

**that arises out of this Agreement or the transaction or relationship created hereby.**

The former, if included in the security agreement, would not cover the debtor’s claims against a repossession agent, but the latter would.<sup>4</sup> Accordingly, if a security agreement contained a clause like the former, whatever language the secured party included in its agreement with a collateral recovery company would probably not be adequate to resolve the problem because the debtor would not have agreed to arbitrate disputes with that company.

**Contents**

***Binding All Relevant Parties to an Agreement to Arbitrate* . . . . . 1**

**Recent Cases. . . . . 3**

### Problem Two – Obtaining an Agreement to Arbitrate from Counter-Parties

The court's ruling was premised largely on the fact that the secured party had not obtained an agreement to arbitrate from either of the other defendants. If the secured party had included an arbitration clause in its agreement with the collateral recovery company, as the court suggested, that would have gone a long way toward solving this problem with respect to the collateral recovery company. Still, it would be advisable for the arbitration clause in that agreement to expressly cover not merely disputes between the two parties, but also any claims brought by the debtor. The arbitration clause should also specify that the parties agree to consolidate any disputes between them with any related claims brought by or against the debtor.

### Problem Three – Obtaining an Agreement to Arbitrate from Non-Contracting Parties

The greatest problem is that the secured party did not hire the repossession agent; the collateral recovery company did. If, as the court ruled, an arbitration clause in the agreement between the secured party and the debtor is not binding on nonsignatories (such as the repossession agent), it is doubtful that an arbitration clause in the agreement between the secured party and the repossession company would be binding on nonsignatories (such as the repossession agent). While an agent *might* be bound by an arbitration clause entered into by the principal,<sup>5</sup> most repossession agents are independent contractors, not true agents. In short, when the court blithely stated that the secured party should have included an arbitration clause “in its contracts with the nonsignatory defendants,” the court overlooked the fact that the secured party did not have a contract with all of those defendants.

There is no perfect solution to this problem. Perhaps the best the secured party can do is to include in its agreement with the collateral recovery company a covenant by that company to include in all its contracts with repossession agents a clause binding the repossession agent to the arbitration clause in the agreement between the collateral recovery company and the secured party.<sup>6</sup> The following clause is an example.

**Obtain Agreement to Arbitrate. If Collateral Recovery Company contracts with any third party to repossess, store, or otherwise deal with any personal property in which Secured Party claims a security interest, Collateral Recovery Company shall include in its contract with such third party an arbitration clause substantially**

**similar to the arbitration clause in this Agreement, so that the third party will be bound to resolve any dispute relating to such contract at the same time and before the same arbitrator that is hearing any related claims by or against Secured Party.**

The problem with this approach is that the collateral recovery company could breach this covenant. If it did, the repossession agent would presumably not be bound to arbitrate. Of course, the collateral recovery company would be liable for that breach, and that liability would presumably cover any increase in litigation costs the secured party incurred as a result of having to litigate in multiple fora. Whether damages could recompense the secured party for inconsistent results is highly questionable.

### Conclusion

When drafting documents for a transaction involving multiple parties – or with respect to which other parties might later become involved – a transactional lawyer should not assume that an arbitration clause in one document or agreed to by one party will be binding on other parties.<sup>7</sup> If, as is likely, it is desirable to avoid multiplicity of actions, along with the expense associated therewith and risk of inconsistent results, the transactional lawyer should seek to harmonize the documents by including the same clause in each or by incorporating by reference in one document the terms in another document. To bind third parties with which the client will have no direct contractual relationship, consider imposing a covenant on a party that does or will have such a contractual relationship.

*Jaxon C. Munns is a first-year student at Gonzaga University School of Law.*

### Notes:

1. Santander Consumer USA, Inc. v. Mata, [2017 WL 1208767](#) (Tex. Ct. App. 2017). The other defendants objected to the motion to compel arbitration. The court did not specify whether the plaintiff also objected to the motion with respect to plaintiff's claims against those other defendants, but the plaintiff's brief indicates that the plaintiff did.

2. The secured party cited authority for the proposition that nonsignatory agents can enforce an arbitration agreement signed by the principals but, as the court observed, those authorities did not compel agents to participate in arbitration based on an agreement signed by the principals and unknown to the agents. *Id.* at \*3.

3. *Id.* at \*4.
4. The arbitration clause at issue in the case did expressly cover claims against third parties. See [Brief of Appellant](#). See also *Baynes v. Santander Consumer USA*, [2018 WL 623582](#) (W.D. Pa. 2018) (the debtor in a secured transaction was required to arbitrate claims against the repossession company that allegedly breached the peace during repossession and the law enforcement personnel who assisted because the security agreement included an arbitration clause covering “all claims arising out of, in connection with, or relating to the Contract” against all persons “who may be jointly or severally liable”).
5. An agent can invoke an arbitration clause entered into by its principal, and thereby compel a third party to arbitrate. See, e.g., *Grand Wireless, Inc. v. Verizon Wireless, Inc.*, [748 F.3d 1](#), 11-12 (1st Cir. 2014); *Jorgens v. Janke*, [77 F. App'x 420](#) (9th Cir. 2003). An agent can also bind a principal to an arbitration agreement entered into within the scope of the agency. See, e.g., *Janiga v. Questar Cap. Corp.*, [615 F.3d 735](#), 743 (7th Cir. 2010). Less clear is whether a principal’s agreement to arbitrate is binding on an agent. See *Ouadani v. TF Final Mile LLC*, [876 F.3d 31](#) (1st Cir. 2017) (ruling that an agent is not so bound).
6. An arbitration clause incorporated into an agreement by reference to another agreement is effective. See, e.g., *Larsen v. Citibank*, [871 F.3d 1295](#), 1306-07 (11th Cir. 2017); *Pagaduan v. Carnival Corp.*, [2017 WL 4117339](#) at \*3 (2d Cir. 2017). See also *Poublon v. C.H. Robinson Co.*, [846 F.3d 1251](#), 1262 (9th Cir. 2017) (an arbitration clause incorporated by reference might be scrutinized more closely for procedural unconscionability, but incorporation by reference, without more, does not make the agreement procedurally unconscionable).
7. The same advice applies to clauses choosing a governing law or forum, waiving the right to a jury, or providing for recovery of attorney’s fees incurred in litigation. See Linda L. Rusch, *Multiple Documents, One Contract?*, [2 THE TRANSACTIONAL LAWYER 2](#) (June 2012); Stephen L. Sepinuck, *Binding Guarantors to Terms in the Note*, [1 THE TRANSACTIONAL LAWYER 1](#) (June 2011); Chelsey Thorne, *An Update on Binding Guarantors to a Forum-Selection Clause*, [4 THE TRANSACTIONAL LAWYER 4](#) (Feb. 2014).



## Recent Cases

### SECURED TRANSACTIONS

*Cozzetti v. Madrid*,

[2017 WL 6395736](#) (Alaska 2017)

A 53-month lease of a mobile home pursuant to which the lessee would become the owner if he made all the payments was a sale and secured transaction. Accordingly, the putative lessor, by representing in a forcible detainer action that the debtor had only a leasehold interest violated the Unfair Trade Practices Act.

*In re Wheeler*,

[2017 WL 6568758](#) (Bankr. W.D. Ky. 2017)

A bank’s perfected security interest became unperfected when the bank mistakenly filed a termination statement, even though 10 minutes later the bank attempted to amend the termination by adding itself as the secured party. Although the termination might have been inadvertent, it was authorized because it was filed by a loan processor of the bank that handles financing statements. As a result, the bank’s security interest became subordinate to another perfected security interest, that previously was junior to the bank’s security interest.

*In re Edwards*,

[2017 WL 6754026](#) (Bankr. E.D.N.C. 2017)

Although a dealer’s compliance with the state certificate of title statute perfected its security interest in a mobile home and all accessions thereto, it did not perfect the security interest in drapes, smoke detectors, ceiling fans, a set of steps, or a 4’-by-4’ porch, each of which was readily detachable and not, therefore, an accession.

*DLA Piper LLP (US) v. Linegar*,

[2017 WL 6559658](#) (Tex. Ct. App. 2017)

The law firm that represented the surviving company in a merger, in connection with which the company received a bridge loan from an entity controlled by one of the company’s principal owners, was liable for malpractice for failing to perfect the security interest that secured the loan. Even though the firm did not represent the secured party or the principal owner, a member of the firm told the principal owner that the security interest was not at risk and that “everything would be taken care of,” and failed to make clear who the firm represented.

*DZ Bank AG v. McCranie*,  
[2018 WL 345045](#) (11th Cir. 2018)

An individual who bought an insurance agency franchise with funding from an entity related to the seller, and who gave the lender a security interest in the agency's assets, had no defense to payment on the note, now owned by an assignee, based on the fact that the seller allegedly breached the franchise agreement. Even though the note referenced several other contract documents, and was therefore not a negotiable instrument, it nevertheless represented a separate obligation so that claims or defenses arising from the purchase were not a defense to payment on the note.

*Genesis Merchant Partners, L.P. v. Gilbride, Tusa, Last & Spellane, LLC*, [2018 WL 358068](#) (N.Y. Sup. Ct. 2018)

Summary judgment could not be granted on a secured party's malpractice claim against the law firm that helped document a transaction secured by insurance policies but which failed to perfect the security interest. Although the firm filed a financing statement, which was effective to perfect the security interest in other collateral but not in the insurance policies, a factual issue remained about the scope of the firm's representation and whether it undertook the duty to perfect the security interest in the policies.

*Cordes v. United States*,  
[2018 WL 496839](#) (D. Colo. 2018)

A secured party that was aware that the two original borrowers and guarantor conducted their business with numerous related entities without regard to corporate separateness, and therefore insisted that many of those other entities grant a security interest in their assets, was not entitled to the portion of a tax refund owed to one entity but which the IRS sought to apply to the tax liability of another entity.

## LENDING & CONTRACTING

*First Home Bank v. Raut, LLC*,  
[2017 WL 6729178](#) (M.D. Fla. 2017)

A creditor's federal action in Florida on a promissory note and the associated guaranty was not subject to the Florida choice-of-forum clause in the security agreement. Consequently, there was no personal jurisdiction over the defendants, and the case would be transferred to federal court in Kentucky, where the defendants were located.

*Dray v. Revah*,  
[2017 WL 6523566](#) (Cal. Ct. App. 2017)

A creditor's action for breach of a secured promissory note was not subject to the arbitration clause in the parties' loan agreement because the promissory note, which was executed three years later and after the borrower defaulted, superseded the loan agreement, given that virtually every aspect of the agreement was changed, including the amount to be repaid, the timing of repayment and term of the loan, the interest rate, the terms regarding default, the creation of a security interest, and terms dealing with governing law, payment of expenses, and waiver.

*Viridis Corp. v. TCA Global Credit Master Funds, LP*,  
[2018 WL 272009](#) (11th Cir. 2018)

A term in each of several amendments to a credit agreement by which the debtor and guarantors released the lender from "any and all . . . claims . . . of any kind whatsoever," was effective to waive claims for usury and for breach or tortious interference with contract arising from conduct occurring before the date of the last amendment. However, the language was not effective to release claims arising from conduct occurring after the date of the last amendment. Nor was it effective to release claims based on fraudulent misrepresentations because it did not expressly indicate that it was incontestable on the ground of fraud.

*Lucas v. Deutsche Bank*,  
[2018 WL 300393](#) (Cal. Ct. App. 2018)

The terms in a note and deed of trust that provided for attorney's fees incurred by the mortgagee in defending its rights to the property or in connection with default to become part of the secured obligation did not authorize a court award of attorney's fees to the mortgagee in connection with its successful defense against the mortgagor's various claims. A term providing for attorney's fees to become part of the debt is not the same as a term authorizing a court award of fees.

*In re Formosa*,  
[2018 WL 494416](#) (Bankr. E.D. Mich. 2018)

A mortgagee was not entitled to an award of attorney's fees incurred in reversing a foreclosure sale conducted without knowledge of the automatic stay because the mortgage provided for recovery of attorney's fees incurred "to protect Lender's interest in the Property," and reversing the foreclosure was not to protect the mortgagee's interest in the property.

*Lynch v. North Am. Co. for Life and Health Insurance*,  
[2018 WL 356161](#) (D. Idaho 2018)

An insurer was not entitled to summary judgment on whether it properly terminated a life insurance policy. Although the policy required merely that advance notification of termination be sent, not that it be received, the insurer's evidence of its customary practices was insufficient to remove a factual issue about whether notification was properly sent to the policy owner in this case, who submitted evidence that no notification was received. There were no computer logs or other records to confirm that the insurer's customary practices were actually followed in this case and the notification was not sent by certified mail.

*In re Lyondell Chemical Co.*,  
[2018 WL 565272](#) (S.D.N.Y. 2018)

Although a lender breached a \$750 million revolving credit facility by failing to lend, the lender was insulated from liability by a term in the credit facility disclaiming consequential damages. Such clauses are enforceable under New York law except to the extent that they cover claims for gross negligence or intentional wrongdoing or are unconscionable, and there was no claim that any of those exceptions applies. However, the clause did not bar restitutionary damages, and thus the lender had to return the \$12 million commitment fee paid by the borrower. While the lender would be entitled to deduct from that amount the value of its partial performance, arising from an earlier loan it made under the credit facility, the lender failed to prove the value of that performance.

*Blok Builders, LLC v. Katryniok*,  
[2018 WL 637399](#) (Fla. Dist. Ct. App. 2018)

A subcontractor on an excavation project that agreed to indemnify the contractor and its agents for any loss or damage resulting from the subcontractor's work was not obligated to indemnify the owner even though: (i) the contractor's agreement with the owner required the contractor to indemnify the owner; and (ii) that agreement was incorporated by reference into the subcontract.

*Helena Chemical Co. v. Holthaus*,  
[2018 WL 623593](#) (D. Kan. 2018)

A secured party that brought an action against the debtor and guarantors on the secured obligation and for replevin was not required to arbitrate the claim. Although the security agreement contained a clause requiring arbitration of any dispute "arising out of or relating to this Agreement," there was no dispute about the extent or scope of the Security Agreement. Instead, the claim related solely to the debt but the loan agreement did not contain an arbitration clause.



**Edited By:**

[Stephen L. Sepinuck](#)

Frederick N. & Barbara T. Curley Professor,  
 Director, Commercial Law Center  
 Gonzaga University School of Law

**Scott J. Burnham**

Former Professor  
 Gonzaga University School of Law

Follow the link below for a detailed list of

[2017 Commercial Law Developments](#)

The file synthesizes more than  
 300 judicial decisions

Also available on the Commercial Law Center's  
[web page](#) is a similar list for each year  
 from 2005 through 2016.

*This newsletter is intended to provide accurate information on the subjects covered. The newsletter is provided for informational purposes only; its publication and distribution do not constitute the provision of legal or professional advice or services by either the authors or the publisher. If legal or professional services are required, the services of a competent professional should be sought.*