Third Circuit Rejects Estoppel Finding and Reverses Order Compelling Arbitration

Marcos A. Ramos and Rachel L. Biblo
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On October 9, 2014, in *Flintkote Co. v. Aviva PLC*, No. 13-4055, the Third Circuit reversed an order holding on an estoppel theory that an insurer was required to arbitrate even though it had no written arbitration agreement with the debtor. The Third Circuit held that the debtor had not presented clear and convincing proof that estoppel should apply.

The Flintkote Company (Flintkote) manufactured asbestos-based products and purchased insurance from leading insurers including Aviva PLC (Aviva). In 1985, Flintkote entered into an agreement with insurers other than Aviva that contained an arbitration clause (the 1985 Agreement). In 1989, Flintkote entered into a similar agreement with Aviva, but Aviva did not consent to arbitration and expressly reserved its right to litigate any disputes.

In 2004, Flintkote filed for bankruptcy. Two years later, Flintkote initiated mediation with its insurers pursuant to a mediation agreement that did not contain an arbitration clause or waive any of the parties' rights. Aviva participated in the mediation and was represented by the same counsel as the other insurers.

Flintkote reached a settlement with some insurers, but not with Aviva, among others. On July 16, 2012, counsel for Aviva and the remaining insurers made demands on Flintkote under the 1985 Agreement and said they would proceed to arbitration absent a resolution. Flintkote took no action in response to the letter except to exchange proposed arbitration agreements with Aviva.

By December 2012, Aviva had separate counsel and was acting independently of the remaining insurers. Aviva moved to lift the automatic stay to pursue a declaratory judgment action concerning the coverage available under its policies. Flintkote filed its own declaratory action in the Delaware district court.

The Bankruptcy Court granted Aviva's motion and lifted the automatic stay. Flintkote then moved in the district court to compel arbitration. The district court granted Flintkote's motion on the grounds that Aviva was equitably estopped from avoiding arbitration due to its extensive participation in the prior mediation process and Flintkote's reliance on Aviva's participation in that process.

On appeal, the Third Circuit stated that arbitration is a question of contract and if "a party has not agreed to arbitrate, the courts have no authority to mandate that he do so." Instead, the presumption in favor of arbitration applies only "when interpreting the scope of an arbitration agreement, and not when deciding whether a valid agreement exists." The court stated that, in the absence of an express agreement to arbitrate, a non-signatory to arbitration can be compelled to arbitrate under traditional principles of contract and agency law, including assumption, piercing the corporate veil, alter ego, incorporation by reference, third-party beneficiary theories, waiver, and estoppel.

The court then looked to Delaware state law to determine whether Flintkote had met its burden of demonstrating that Aviva was equitably bound to arbitration on the grounds (as argued by Flintkote) that (i) Aviva "knowingly exploited" and benefitted from the 1985 agreement and (ii) Aviva's participation in the mediation process had caused Flintkote detrimentally to change its position. Delaware imposes a burden of clear and convincing proof on the party asserting estoppel. The doctrine of "knowing exploitation" requires a party to "embrace" a contract in order to be held to the entirety of the terms thereof. Delaware further provides that a party may be found to "embrace" a contract where the non-signatory (i) directly rather than indirectly benefits from the agreement, (ii) consistently maintains that certain provisions of the contract should be enforced to benefit it, or (iii) sues to enforce the provisions it likes. When evaluating these factors, however, a court "must proceed with a good deal of caution . . . lest nuanced concepts of equity be allowed to override established legal principles of contract formation."

The court held that Flintkote failed to establish that Aviva had "embraced" the 1985 agreement. The court noted that the mediation in Flintkote's bankruptcy case occurred pursuant to a mediation agreement, not the 1985 Agreement, and therefore Aviva was not "embracing" the 1985 Agreement by participating in mediation. Moreover, Aviva's counsel's July 16, 2012 letter and related reference to arbitration under the 1985 Agreement were not sufficient to show that Aviva had "consistently" sought any benefit under the

1985 Agreement.

The court also held that Flintkote had not changed its position in justifiable reliance on Aviva's actions. The court noted that Flintkote was a signatory to the 1989 agreement under which Aviva expressly retained its right to litigate, and therefore, Flintkote knew that Aviva had negotiated for and specifically reserved this right. Moreover, the mediation agreement did not waive Aviva's rights. Accordingly, Flintkote's reliance on the idea that, after participating in the mediation for six years, Aviva would arbitrate any unresolved disputes was not reasonable and could not, on an estoppel theory, require Aviva to arbitrate. The court also refused to infer an implied-in-fact contract mandating arbitration because an express contract (the 1989 agreement) already addressed the arbitration issue.

Marcos A. Ramos *is a director, and* ***Rachel L. Biblo*** *is an associate (not yet admitted to practice), of Richards, Layton & Finger. The views expressed in this article are those of the author and not necessarily those of his firm or clients.*