

**IN THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA**

**CHARLESTON DIVISION**

TIMOTHY C. BAILEY, et al.,

Plaintiffs,

v.

CIVIL ACTION NO. 2:08-cv-00146

PRE-SETTLEMENT FINANCE, L.L.C., et al.,

Defendants.

**ORDER**

Pending before the court is the Motion to Stay filed by defendant Pre-Settlement Finance, LLC [Docket 8]. For the reasons that follow, the defendant's motion is **DENIED**.

**I. Background**

Bill Thompson filed suit against Logan County Mine Services, Inc., sometime in 2004. After he filed suit, but before he had recovered any money from judgment or settlement, Mr. Thompson entered into a finance agreement with Pre-Settlement Finance, LLC ("PSF") on February 28, 2005. That agreement, executed by Mr. Thompson on behalf of himself and by Carmine DeSantis on behalf of PSF, provided \$10,000 to Mr. Thompson (hereafter "Finance Agreement"). In exchange for the funds, Mr. Thompson granted PSF a non-recourse security interest and lien in any amounts he received due to settlement or judgment, agreed to a \$600 "Origination Fee," and also agreed to a \$250 "Processing Fee." Mr. Thompson also agreed to a 3.5% *monthly* compound interest rate on the principal amount (42% annual percentage rate) called a "monthly usage fee." If Mr. Thompson recovered nothing from his suit, he had no obligation to PSF. (Def. Mot. Stay, Ex. 1.)

On March 7, 2005, the plaintiff in this action (Mr. Thompson's lawyer in the underlying suit) wrote a letter to PSF that stated the following:

After discussion with you today and with my client, I provide my following acknowledgment that Mr. Thompson has received funds from your company which he has agreed to repay at settlement or verdict in his lawsuit. \* \* \* I have retained photocopies of the agreement for my files. My client has directed me to honor his agreement with your company at disbursement. Ethically and prudently I can make no promise to another entity which may place me in an adversarial position to my client. Your agreement is between your company and Mr. Thompson. I will not become a "party" or "guarantee" to the agreement. I am prohibited from doing so under the Rules. While I will honor my client's wishes to repay your moneys, I do so because my client directs me and not by any agreement I have with your company. Given my client's express directive to me concerning the moneys advanced him, I am hopeful you and he can complete your transaction.

(Pl.'s Mot. Stay [Docket 13], Ex. D.)

At some point in May 2007, Mr. Thompson reached a settlement in his suit with Logan County Mine Services. PSF alleges that neither Mr. Thompson nor the plaintiffs informed PSF of the settlement. PSF further alleges that the plaintiffs disbursed all settlement amounts to Mr. Thompson. PSF apparently sought reimbursement from the plaintiffs in this case because it was unable to recover the amount from Mr. Thompson. On February 12, 2008, the plaintiffs filed the instant suit in Kanawha County Circuit Court, seeking Declaratory Judgment and Injunctive relief. The plaintiffs specifically request that this court: (1) declare that they were not parties to the Finance Agreement executed by Mr. Thompson and PSF, (2) declare that the plaintiffs owed no legal obligation to the defendants, and (3) any other relief provided by law.<sup>1</sup> Three days later the plaintiffs

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<sup>1</sup> The plaintiffs additionally sought a declaration prohibiting the defendants from: filing any lawsuit against the plaintiffs, filing any recording or otherwise reporting a lien or judgment obtained against the plaintiffs, executing any judgment or lien against the plaintiffs, and filing a complaint with the West Virginia Bar. The plaintiffs also ask the court to find that the plaintiffs are not subject to personal jurisdiction in the New York courts, that the defendants have committed fraud and (continued...)

filed a Motion for Temporary Restraining Order. After receiving the Motion for Preliminary Injunction, but before a hearing on the matter, the defendants initiated an arbitration proceeding with the American Arbitration Association (AAA) on February 21, 2008. The Kanawha County Circuit Judge, the Hon. Jennifer Bailey Walker, held a hearing on the Motion for Preliminary Injunction and Temporary Restraining Order on February 25, 2008. After the hearing, Judge Walker entered an “Order Staying Action Pursuant to Parties’ Agreement to For[e]go Commencing Other Proceedings,” in which Judge Walker stayed the proceeding until further notice and set the plaintiffs’ Motion for Preliminary Injunction for hearing on March 6, 2008 at 9:30.

Notwithstanding the agreement to stay the action and Judge Walker’s order that the case was stayed, the defendants removed the case to this court on March 5, 2008. On March 6, 2008, the day that the parties were scheduled to attend the hearing in Judge Walker’s court, the defendants filed a separate suit in New York state court, seeking to compel the arbitration that the defendants had previously initiated.<sup>2</sup> After filing suit in New York seeking to compel arbitration, PSF filed the instant Motion to Stay in this case, arguing that the parties were subject to arbitration, and that this court should enter a stay pending resolution of the arbitration.

In its Memorandum in Support, PSF argues that the court should stay this action because the plaintiffs are subject to the arbitration provision in the Finance Agreement signed by Mr. Thompson and PSF. They argue that, even though the plaintiffs are non-signatories to the contract, they are

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<sup>1</sup>(...continued)  
extortion, and other relief.

<sup>2</sup> The court admits to being baffled as to why the defendants filed a separate suit in New York to compel arbitration when they could have easily filed a motion to compel arbitration in this court – the court to which they removed the case.

subject to the contractual arbitration provision for several reasons. First, PSF argues that the Federal Arbitration Act (FAA), 9 U.S.C. §§ 1 to 16, applies, and that the policy to arbitrate must be construed liberally and broadly. Second, PSF argues that – although the plaintiffs did not execute the Finance Agreement – they are bound as non-signatories because of statements in their letters which indicate an intention to honor their client’s wishes. Third, they argue that the plaintiffs are subject to the arbitration provision because of “(1) incorporation by reference; (2) assumption; (3) agency; (4) veil piercing/alter ego; and (5) estoppel.” (Def. Mem. Supp. Mot. Stay p.8-9 (citing *Thomson-CSF, S.A. v. American Arbitration Ass’n*, 64 F.3d 773, 775 (2d Cir. 1995).) Further, PSF argues that the plaintiffs are subject to the arbitration provision because of the closeness of the relationship between PSF and the plaintiffs; because of the relationship of the alleged wrongs to the non-signatory’s obligations and duties in the contract; and because the claims were intimately founded in and intertwined with the underlying contract obligations. (Def. Mem. Supp. Mot. Stay p.10-11 (citing *McBro Planning and Dev. Co. v. Triangle Elec. Const. Co., Inc.*, 741 F.2d 342, 343-44 (11th Cir. 1984).)

## **II. Discussion**

### A. Applicable Law

It is a well-established principle that “arbitration is a matter of contract interpretation and a party cannot be required to submit to arbitration any dispute which he has not agreed to so submit.” *Am. Bankers Ins. Group, Inc. v. Long*, 453 F.3d 623, 626-27 (4th Cir. 2006) (citing *Int’l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, 416 (4th Cir. 2000)). It is equally well-settled, however, that “in an appropriate case a nonsignatory can enforce, or be bound by, an arbitration provision within a contract executed by other parties.” *Int’l Paper Co.*, 206 F.3d at 416-

417. An appropriate case typically arises when “‘theories arising out of common law principles of contract and agency law’ are used to bind nonsignatories to arbitration agreements.” *R.J. Griffin & Co. v. Beach Club II Homeowners Ass’n*, 384 F.3d 157, 160 (4th Cir. 2004) (citing *Int’l Paper Co.*, 206 F.3d at 417).<sup>3</sup>

As the Fourth Circuit has recognized, there are five theories which could bind a nonsignatory to an arbitration agreement: 1) incorporation by reference, 2) assumption, 3) agency, 4) veil piercing/alter ego, and 5) estoppel. *Int’l Paper Co.*, 206 F.3d at 417 (citing *Thomson-CSF*, 64 F.3d at 776). Of particular relevance is the theory of equitable estoppel, given the defendant’s reliance on this theory.

#### B. Analysis

It is clear beyond all dispute that the plaintiffs did not sign the Finance Agreement that is the subject of this lawsuit and that contains the arbitration provision that the defendants seek to enforce. (See Def.’s Mot. to Stay Ex. A [Docket 8].) Because the defendant concedes this fact, the defendant argues the plaintiffs should be forced to submit their claims to arbitration under four of the theories set forth above. It is readily apparent, however, that the theories of incorporation by reference, assumption, and agency do not bind the plaintiffs to an arbitration agreement to which they did not sign.

##### *1. Incorporation by Reference*

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<sup>3</sup> As the Fourth Circuit noted in *R. J. Griffin & Co.*, the federal substantive law of arbitrability governs whether a nonsignatory is bound by an arbitration provision. 384 F.3d at 160 n.1; but see *Long v. Silver*, 248 F.3d 309, 320 (4th Cir. 2001) (“A non-signatory may invoke an arbitration clause under ordinary state-law principles of agency or contract.”).

The defendant first argues that “[t]he letter sent by the plaintiffs to PSF on March 7, 2005, . . . , wherein the plaintiffs agreed to ‘honor [their client’s] agreement with [PSF] at disbursement’ and ‘honor my client’s directives as to payment of proceeds’ clearly incorporates the FUNDING AGREEMENT by reference and thus incorporate the covenant to arbitrate.” (Def.’s Mem. 9 [Docket 9].) For incorporation by reference to be applicable, however, the defendant must have “entered into a separate contractual relationship with the nonsignatory which incorporates the existing arbitration clause.” *Thomson-CSF*, 64 F.3d at 777. Here, there is no evidence that the plaintiffs entered any contractual relationship with the defendant, let alone one that incorporated the Finance Agreement’s arbitration provision. The defendant points to the plaintiffs’ letters, but these merely mention the Finance Agreement, they do not incorporate it. (Pls.’ Combined Mot. Ex. D.) Consequently, the court **FINDS** that incorporation by reference does not provide a means of binding the plaintiffs to the arbitration provision in the Finance Agreement.

## 2. Agency

The defendant also contends that “Mr. Thompson and the plaintiffs herein are linked by contract and the principles of agency and thus the plaintiffs are bound by virtue of those jural relationships.” (Def.’s Mem. 9.) The defendant does not discuss what contract binds Mr. Thompson to the plaintiffs or how the principles of agency bind the plaintiffs. Presumably the defendant relies on the rule that “a non-signatory may be compelled to arbitrate under an agency theory if a signatory signed the arbitration agreement as the non-signatory’s agent” or if the non-signatory “so dominated a signatory that it is appropriate to pierce the signatory’s corporate veil and hold the non-signatory liable on the contract containing the arbitration provision.” *World Rentals & Sales, LLC. v. Volvo Const. Equipment Rents, Inc.*, \_\_\_ F.3d \_\_\_, 2008 WL 466127, at \*6 (11th Cir. Feb. 22, 2008). These

rules are inapplicable to this case. The defendant has not argued or alleged that when Mr. Thompson signed the Finance Agreement, he was acting as the plaintiffs agent. Nor could it, because the defendant admits that the plaintiffs were Mr. Thompson's agents. (Def.'s Mem. 7 (noting that the plaintiffs "were agents and attorneys for Mr. Thompson".)) Furthermore, there is no evidence that the plaintiffs dominated Mr. Thompson and thus persuaded him to sign the Finance Agreement. The evidence available to the court indicates that Mr. Thompson's decision to enter into the Finance Agreement was his own, and that the plaintiffs became aware of his decision. The court therefore **FINDS** that the principles of agency do not subject the plaintiffs to arbitration.

### *3. Assumption*

The third theory upon which the defendant relies is assumption. The defendants do not argue assumption explicitly, but rather imply that this theory applies. For example, the defendant states that the principles of agency bind the plaintiffs to arbitration "even if they hadn't covenanted in their own right to honor the FINANCE AGREEMENT by their letters of March 7, 2005." (Def.'s Mem. 9-10.) Likewise, the defendant states that "that the plaintiffs bound themselves to honor their client's contract is amply demonstrated by the plaintiff's two letters to the defendant PSF dated March 7, 2005.)

Under the assumption theory, "a party may be bound by an arbitration clause if its subsequent conduct indicates that it is assuming the obligation to arbitrate." *Thomson-CSF*, 64 F.3d at 777. Here, however, the plaintiffs' letters unambiguously indicate that the plaintiffs are not assuming the Finance Agreement at all, let alone the arbitration provision. In the letter, Mr. Bailey states that "[y]our agreement is between your company and Mr. Thompson. I will not become a 'party' or 'guarantee' to the agreement. I am prohibited from doing so under the Rules." (Pls.'

Combined Mot. Ex. D.) Contrary to the defendant's assertions, the plaintiffs did not in the letters agree to assume the obligations of the Finance Agreement, they merely reaffirmed their duty to abide by the wishes of their client, which at the time included following his instructions regarding disbursement of fees." Thus, it is apparent that the plaintiffs did not assume the obligation to arbitrate, and the court **FINDS** that the plaintiffs are not bound to arbitrate based on an assumption theory.

#### 4. *Equitable Estoppel*

The defendants argue that the plaintiffs are bound by the arbitration clause as non-signatories under the law of equitable estoppel. As the Fourth Circuit has held:

"Equitable estoppel precludes a party from asserting rights he otherwise would have had against another when his own conduct renders assertion of those rights contrary to equity." *Int'l Paper*, 206 F.3d at 417-18 (internal quotation marks omitted). "In the arbitration context, the doctrine recognizes that a party may be estopped from asserting that the lack of [another's] signature on a written contract precludes enforcement of the contract's arbitration clause when [the party] has consistently maintained that other provisions of the same contract should be enforced to benefit him." *Id.* at 418.

\* \* \*

The "legal principle [underlying the theory of equitable estoppel] rests on a simple proposition: it is unfair for a party to rely on a contract when it works to its advantage, and repudiate it when it works to its disadvantage."

*American Bankers Ins. Group, Inc. v. Long*, 453 F.3d 623, 626-28 (4th Cir. 2006).

The typical equitable estoppel case involves one of a few scenarios. As outlined above, the legal principle prevents a party from selectively enforcing a contractual provision (*i.e.*, a non-signatory attempting to enforce a purchase price provision, but repudiating the arbitration provision because of the party's non-signatory status). *See id.* at 626-28. The doctrine also applies when a signatory seeks to avoid arbitration because another party had not signed the agreement. In those scenarios, equitable estoppel applies to prevent the signatory from avoiding arbitration when the

basis of the claim nevertheless arises from the agreement which contains the arbitration provision.  
*Id.* at 626-28.

Finally, the court has also recognized a separate situation such as the case here: when a non-signatory sues a signatory.

[J]ust as estoppel can apply against a signatory to an arbitration clause who sues a nonsignatory thereto, it can also apply against a nonsignatory who sues a signatory. *See, e.g., R.J. Griffin, 384 F.3d at 160-64; Int'l Paper, 206 F.3d at 416-18. In such a situation, however, we have stated, in language different from Brantley's "rely on" test, that a non-signatory will be estopped when his underlying claims seek a "direct benefit" from the contract containing the arbitration clause, R.J. Griffin, 384 F.3d at 162. Although R.J. Griffin's language is different from Brantley's, the "direct benefit" test, similar to the "rely on" test, recognizes that a nonsignatory should be estopped from denying that it is bound by an arbitration clause when its claims against the signatory "arise[ ]from" the contract containing the arbitration clause. Id.*

*American Bankers Ins.*, 453 F.3d at 628 (emphasis added).

Here, the plaintiffs claims against the defendants are not based on the contract. To the contrary, the plaintiffs wish to distance themselves from the contractual arrangement between PSF and Mr. Thompson. They seek a declaratory judgment that they are neither subject to nor bound by the contract – in its entirety. No claim in their complaint “arises from” something they would have otherwise received under the contract. Indeed, the plaintiffs received no benefit from the contract between Mr. Thompson and PSF, a conclusion supported by the reluctance Mr. Bailey expressed in his March 7, 2005 letter to PSF. Even if the plaintiffs had received some sort of benefit under the contractual terms (*e.g.*, the financial arrangement permitted the Mr. Thompson to prolong the prosecution of his case and settle for a higher sum, thereby resulting in a higher fee for the plaintiffs in this case), it cannot accurately be described as a “direct benefit.” The benefit, if any, would be best characterized as remote or tangential. I therefore **FIND** and **CONCLUDE** that the doctrine of

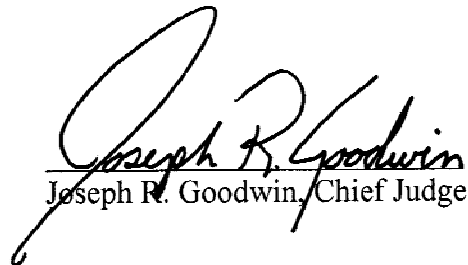
equitable estoppel does not apply, and the non-signatory plaintiffs are therefore not bound by the arbitration provision. It follows, and I **FIND** that the plaintiffs' claims are not subject to the arbitration proceeding.

### **III. Conclusion**

Because the plaintiffs do not seek to receive relief that is a "direct benefit" from the contract entered into by PSF and Mr. Thompson, and because no other theory of equitable estoppel applies, the court **FINDS that the plaintiffs are not subject to the arbitration clause, and are not compelled to participate in the arbitration.** The defendants' Motion to Stay [Docket 8] is therefore **DENIED.** The counsel are **DIRECTED** to attend a **scheduling conference**, in Charleston, on **March 24, 2008, at 10:00 a.m.**

The court **DIRECTS** the Clerk to send a copy of this Order to counsel of record and any unrepresented party.

ENTER:        March 21, 2008

  
Joseph R. Goodwin, Chief Judge