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Court Lets Go of the Reins: Runaway Escrow Agent Binds Principals to Arbitration Agreement - 99 Commercial Street, Inc. v. Goldberg

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NOTES

Court Lets Go of the Reins: Runaway Escrow Agent Binds Principals to Arbitration Agreement

99 Commercial Street, Inc. v. Goldberg[1]

I. INTRODUCTION

Arbitration agreements are a step in the right direction for alternate dispute resolution. Obviously, before a court can grant a motion to compel arbitration pursuant to such an agreement, it must find that both parties are, indeed, bound by that agreement.[2] Although a traditional contract law analysis is ordinarily used to determine who is bound to a contract containing an arbitration provision, when an escrow agent acting on behalf of one party to a contract binds that party to an agreement to arbitrate, traditional contract law analysis must be altered to take into account the extent of an escrow agent's power to bind its principals. This Note examines the analysis as utilized by a federal court in the Southern District of New York when confronted with such a situation and suggests that an escrow agent, by its very nature, does not possess the ability to bind its principal to an agreement to arbitrate a dispute with another party.

II. FACTS AND HOLDING

The underlying claim in this case arose when 99 Commercial Street, Inc. ("99 Commercial Street"), a real estate developer in New York City, and its principals/owners Martin Kennedy and Clark McLain (together "Plaintiffs") filed a securities violation suit against Gary Goldberg & Co., a securities broker-dealer, and its president Gary H. Goldberg (together "Defendants").[3] Defendants moved to compel arbitration of the claims according to the terms of a customer agreement which contained an arbitration clause.[4] This customer agreement and the circumstances surrounding its formation provide the basis for the legal question at issue.

The events giving rise to Plaintiffs' suit began when Plaintiffs mortgaged their homes and a building located at 99 Commercial Street in order to raise

1. 811 F. Supp. 900 (S.D.N.Y. 1993).
2. McAllister Brothers, Inc. v. A & S Transportation Co., 621 F.2d 519, 522 (2d Cir. 1980).
3. *99 Commercial Street*, 811 F. Supp. at 902.
4. *Id.* at 903.

capital to acquire a piece of property located adjacent to the building.[5] The mortgage, with Liberty Credit Corporation ("LCC"), allowed Plaintiffs to raise $1.3 million.[6] Kennedy and McLain became involved with Defendants while seeking advice on how to invest the mortgage proceeds while waiting for the property to become available for purchase.[7] Goldberg advised plaintiffs to invest the proceeds into three specific funds which his company managed or owned.[8]

Following the closing of the mortgages, and pursuant to Goldberg's instructions, McLain deposited $1 million of the proceeds with Bear, Stearns & Co. ("Bear Stearns"), Defendants' clearing house, thus creating a commercial account (the "Commercial Account") through which investment transactions would occur.[9] Plaintiffs denied receiving any customer agreement pertaining to this Commercial Account.[10] Further, there was no evidence of such an agreement, except that Bear Stearns routinely sends an executed customer agreement containing an arbitration provision to its clients.[11]

LCC and Plaintiffs placed one hundred thousand dollars of the mortgage proceeds into an escrow account (the "Escrow Account") to "secure completion of certain conditions" which were not yet complete at the time of the closing with LCC.[12] The law firm of Steckler, Gutman, Morrisey & Murray ("Steckler & Gutman"), LCC's attorneys, acted as escrow agent for the account.[13] Partners of Steckler & Gutman, in their capacity as escrow agents, signed a customer agreement with Bear Stearns (the "Customer Agreement") for the eventual investment of the money held in the Escrow Account.[14] The partners signed their own names, but Bear Stearns' records reflect that the account name was "'FBO (for the benefit of) 99 Commercial St., Inc.'"[15]

This Customer Agreement provided in part that all of its provisions, including an arbitration clause, were applicable to all matters between or among the customer [Plaintiffs], the broker [Defendant] and/or Bear Stearns. Further, the agreement provided that the customer [Plaintiffs] agreed that the broker [Defendant] was a third party beneficiary of this Agreement, and that the terms and conditions contained therein, including the arbitration provision, would be applicable to all matters between or among the customer, the broker or Bear

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5. *Id.* at 902.
6. *Id.*
7. *Id.*
8. *Id.* at 902-03. These three funds included: an MFS Government Market Income Trust, an MFS Intermediate Income Trust, and a VMS Mortgage Investment Fund. *Id.* at 902.
9. *Id.* at 903.
10. *Id.*
11. *Id.*
12. *Id.* The escrow agreement specified that the money "would be held by the escrow agents in 'one or more interest bearing account [sic] with the interest for [99 Commercial's] benefit.'" The interest earned would be held in escrow and would be paid upon completion of the matter. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*

Stearns.[16] Finally, the agreement provided that any "controversies arising between [the customer] and Bear Stearns concerning [the customer's] accounts or this or any other agreement with Bear Stearns, whether entered prior to, on or subsequent to the date hereof, shall be determined by arbitration."[17]

Plaintiffs invested the money in the Commercial and Escrow Accounts in the funds which Goldberg suggested, and the values dropped sharply.[18] Plaintiffs closed these accounts and commenced an action against Goldberg asserting securities fraud and racketeering activity.[19] Plaintiffs claimed that Defendants "made a series of fraudulent misrepresentations" and induced them to invest the proceeds into Defendants' funds.[20]

Defendants made a motion to compel arbitration of the claims according to the terms of the Customer Agreement signed by the escrow agents on behalf of Plaintiffs with Bear Stearns.[21] Defendants based their motion on the argument that Plaintiffs were owners of the Escrow Account, and were, therefore, bound by the Customer Agreement signed by the escrow agents, Steckler & Gutman, which included the arbitration provision.[22] Plaintiffs argued that they did not own the Escrow Account at the time the Customer Agreement was executed or alternatively that they did not authorize the escrow agents to execute the customer agreement on their behalf, and as a result were not bound by the arbitration clause.[23]

The District Court for the Southern District of New York granted Defendants' motion to compel arbitration and ordered Plaintiffs to submit their claim to arbitration, by holding that a Brokerage Agreement containing an arbitration clause signed by an escrow agent in his capacity as escrow agent for the principal was sufficient to bind the principal/investing customer to the agreement to arbitrate.[24]

III. LEGAL HISTORY

The legal background of this case is best thought of as a pyramid. The pyramid on which the instant case is constructed is broad at its base with a great deal of general case law regarding enforceability of arbitration agreements. As the pyramid narrows, there is less case law about binding a nonsignatory to an arbitration agreement. Even less case law exists when this topic is placed in the context of the securities industry. Finally, the top of the pyramid provides only a small niche of law dealing with an escrow agent's ability to bind a principal in

16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.* at 902.
20. *Id.*
21. *Id.* at 903.
22. *Id.*
23. *Id.* at 904.
24. *Id.* at 902.

the securities arena to an arbitration agreement. Unfortunately, even an extensive examination of these cases does not provide a clear cut answer to the question at issue; but examined together they provide a method of reaching a logical conclusion applicable to this question.

A. Arbitration Agreements

There can be no question that the legislature and the federal court system stand squarely behind the resolution of claims by arbitration.[25] The Supreme Court has interpreted Section 2 of the Federal Arbitration Act as "a congressional declaration of a liberal federal policy favoring arbitration agreements."[26] Moreover, any doubts as to whether an issue is arbitrable are resolved in favor of arbitration.[27]

The first step following a motion to compel arbitration pursuant to an agreement is for the court to decide if the parties have, indeed, agreed to arbitrate their claims.[28] This first step is crucial because arbitration is completely consensual and "a party cannot be required to submit to arbitration any dispute which he has not agreed to submit."[29] In making this initial determination, courts deal with agreements to arbitrate as a matter of contract law.[30] Therefore, whether a party has agreed to arbitration is to be determined by ordinary contract principles.[31]

B. Enforceability of Arbitration Agreements on Nonsignatory Parties

Obviously, a party's intent to be bound to an agreement to arbitrate can be evidenced by her signature. Parties can, however, become contractually bound to arbitrate disputes absent their own signature.[32] For example, a court may pierce the corporate veil and bind to an arbitration agreement a company which is the "signatory's alter ego."[33] In addition, a nonsignatory may be bound to an agreement to arbitrate which is "implied from the party's conduct."[34] Finally, according to contract law, a court may apply agency principles to bind a

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25. *See* 9 U.S.C. § 1 et seq. (1988) [the Federal Arbitration Act]; Moses H. Cone Memorial Hospital v. Mercury Construction, 460 U.S. 1 (1983).

26. *Moses H. Cone*, 460 U.S. at 24 (interpreting 9 U.S.C. § 2).

27. *Id.* at 24-25.

28. Okcuoglu v. Hess, Grant & Co., 580 F. Supp. 749, 750 (E.D. Pa. 1984).

29. Continental Group v. NPS Communications, Inc., 873 F.2d 613, 617 (2nd Cir. 1989).

30. *McAllister Brothers Inc.*, 621 F.2d at 522.

31. *Ockuoglu*, 580 F. Supp. at 750 (citing Fox v. Merrill Lynch & Co., Inc., 453 F. Supp. 561, 564 (S.D.N.Y. 1978)).

32. Fisser v. International Bank, 282 F.2d 231, 233 (2nd Cir. 1960).

33. Interocean Ship Co. v. National Shipping and Trading Corp., 523 F.2d 527, 539 (2nd Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976).

34. Gvozdenovic v. United Air Lines, Inc., 933 F.2d 1100, 1105 (2d Cir. 1991), *cert. denied*, 112 S.Ct. 305 (1991).

nonsignatory principal to an agreement, containing an arbitration provision, signed by the principal's agent.[35]

In order to analyze whether a nonsignatory principal is bound to an arbitration agreement signed by an agent, a court looks to the law of agency within the law of contracts.[36] In making this analysis, a court must decide if the agent possessed the requisite authority to bind his principal, by examining all the facts and circumstances of the case.[37] An agent's authority may be actual or apparent, implied or express.[38] If such authority is present, then an agent's actions within that authority will be binding on the principal.[39] Therefore, if the court can find some authority for an agent to bind a principal to an agreement containing an arbitration provision, then the principal will be bound to that agreement to arbitrate.

C. Application in the Securities Field

However, this examination of the law is not sufficient to answer the question at hand. We must take this legal blueprint used to determine the enforceability of arbitration agreements and place it in the context of brokerage agreements containing arbitration provisions. The current standard practice in the securities field is for investor/customers to sign a brokerage contract which governs the investor-broker relationship and usually contains provisions for mandatory arbitration of disputes arising out of the securities relationship.[40] A series of cases handed down by the United State Supreme Court from 1953 to 1989, enforcing pre-dispute agreements in the securities field, reflects the expansion of the favorable view toward such agreements.[41] In fact, the holdings in two of the more seminal cases on the topic appear to stand for the enforceability of all pre-dispute agreements to arbitrate contained in brokerage contracts.[42]

Such agreements to arbitrate in the securities industry, similar to agreements previously discussed, must also be scrutinized according to ordinary contract

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35. *See* Peoples Federal Savings & Loan Association v. Mortgage Government Securities, Inc., CIV. A. 87-3859, 1988 WL 59729 (May 4, 1988 E.D. La.).

36. *99 Commercial Street*, 811 F.Supp. at 905.

37. 2A C.J.S. *Agency* § 174 (1972 & Supp. 1994).

38. *99 Commercial Street*, 811 F. Supp. at 906. The necessary authority for an agent to bind a principal may vary according to state law. The *99 Commercial Street* court, a federal district court sitting in New York, describes the requisite authority as is stands under New York law.

39. *Id.*

40. Eileen P. Kelly, Eugene L Donahue & Lawrence S. Clark, *Legal and Ethical Perspectives on the Use of Arbitration in the Security Industry*, 25 CREIGHTON L. REV. 1311, 1311 (1992).

41. Jim Parks, *Just Saying No: Avoiding Pre-dispute Agreements to Arbitrate in Securities Cases*, 1990 J. DISP. RESOL. 117, 122 (1990). Author discusses chronologically the expanding acceptance of pre-dispute agreements to arbitrate in the securities arena. *Id.* at 122-26.

42. Parks, *supra* note 41, at 127 (discussing Shearson/American Express v. McMahon, 482 U.S. 220 (1987); Rodriguez De Quijas v. Shearson/American Express, 490 U.S. 477 (1989)).

principles.[43] Therefore, traditional contract defenses can be asserted to prevent the enforcement of a contract containing an arbitration provision.[44] Similarly, the principles of agency law also affect the interpretation of who is bound to an agreement to arbitrate in a securities agreement.[45]

As discussed above, the courts also have found different situations involving securities transactions in which contracts containing arbitration provisions will be enforced by and against nonsignatories. In the securities arena, a nonsignatory has been allowed to enforce an arbitration agreement in two situations where there has been a "meeting of the minds" on the issue.[46] First, where the introducing broker is an obvious and disclosed agent of the clearing broker with whom the agreement was signed, the introducing broker may enforce an agreement signed by the customer containing an arbitration provision.[47] Second, where the introducing broker is a third party beneficiary by the language of the brokerage agreement or some other manifestation of the parties' intent, they may also enforce an arbitration agreed to by an investing customer.[48]

Often in a securities relationship, a broker will act as the agent for an investor in a transaction with a third party such as a clearing house.[49] Courts are split in the determination of the requisite circumstances for a broker to bind an investor to an arbitration agreement by signing the agreement as agent for the investor.[50] Certain courts have held that an investor will be bound to an arbitration clause contained in the clearing house agreement signed by a broker. The court in *Okcuoglu v. Hess, Grant & Co., Inc.*,[51] held that consent may be implied in law because an introducing broker is deemed to be the agent of the clearing broker with whom the investor entered into agreement.[52] Because the parties in *Okcuoglu* conducted themselves in accordance with these arrangements for a five year period, a failure to specifically mention the introducing broker in the customer agreement did not prevent the enforceability of the arbitration clause in claims against the introducing broker.[53] Similarly, the court in *Nesslage v.*

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43. *Okcuoglu*, 580 F. Supp. at 750; Parks, *supra* note 41, at 133 (quoting the Federal Arbitration Act, which holds in part that "all agreements to arbitrate [are] 'valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.'").

44. Parks, *supra* note 41, at 133. Author lists possible traditional contract defenses such as unconscionability because a contract of adhesion, fraud in the inducement, lack of valid offer or acceptance, mistake, misunderstanding, or unauthorized modification. *Id.* at 133.

45. *Okcuoglu*, 580 F. Supp. at 750 (case involving an introducing broker acting as agent for investor in transactions with clearing house).

46. Mowbray v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 795 F.2d 1111, 1116 (1st Cir. 1986).

47. *Okcuoglu*, 580 F. Supp at 751.

48. Nesslage v. York Securities, Inc., 823 F.2d 231, 233 (8th Cir. 1987).

49. *See, e.g., Nesslage*, 823 F.2d 231; *Okcuoglu*, 580 F. Supp. 749.

50. *See supra*, notes 48-49 and accompanying text; *supra*, notes 51-58 and accompanying text.

51. 580 F. Supp. 749 (E.D. Pa. 1984).

52. Shaffer v. Stratton Oakmont, Inc. 756 F. Supp. 365, 367 (N.D. Ill. 1991) (citing *Okcuoglu*, 580 F. Supp. at 750).

53. *Okcuoglu*, 580 F. Supp. at 751.

York Securities, Inc.,[54] determined that all of the parties involved intended for the agreement between the clearing broker and the investor to apply to the introducing broker as a third party beneficiary.[55] In addition, in a slightly different situation, where the party, who actually signed the agreement, trying to enforce the arbitration provision was an employee of the brokerage company, the court held that "[a]cts by employees of one of the parties to a customer agreement are equally arbitrable as acts of the principals as long as the challenged acts fall within the scope of the customer agreement."[56]

There are courts, however, that refuse to enforce such agreements, signed on behalf of an investor, absent evidence of actual intent on the part of the investor to be bound by an agreement to arbitrate with a particular party.[57] The court in *Mowbray v. Moseley, Hallgarten, Estabrook & Weeden*,[58] held that an arbitration provision involves important procedural rights and is not an obvious incident to an introducing broker's power as agent.[59] Following this reasoning, the court in *Shaffer v. Stratton*[60] held that the power to compel arbitration is not a part of an introducing broker's power absent a "substantial factual showing that the investor knowingly consented to such an exercise of power."[61] Thus, while agreements to arbitrate claims in the complex securities arena are generally enforceable, there is a split of authority as to a investor's ability as a nonsignatory to enforce, rely or be a party to such an agreement.

D. Power of an Escrow Agent to Bind a Principal to an Arbitration Agreement

This analysis, however, still does not complete the necessary analysis for the situation in the instant case. We must now make a transition to the topic of an escrow agent's powers in a securities relationship. The majority of case law applicable to escrow agents addresses the extent of the escrow agent's duties and liability. One Florida court discussing the sources of an escrow agent's duties states in part that:

> The law of escrow does not fall neatly within the established rules of either contract, agency or trust. The law of escrow is complicated primarily by the fact that the escrow agent or depositary provides a service to at least two parties with potential or actual adverse interests.

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54. 823 F.2d 231 (8th Cir. 1987).
55. *Id.* at 233.
56. Scher v. Bear Stearns & Co., 723 F. Supp. 211, 216 (S.D.N.Y. 1989).
57. *See Mowbray*, 795 F.2d at 1117; *Shaffer*, 756 F. Supp. at 369; Wilson v. S.H. Blair & Co., 731 F. Supp. 1359 (N.D. Ind. 1990); Lester v. Basner, 676 F. Supp. 481 (S.D.N.Y. 1987).
58. 795 F.2d 1111 (1st Cir. 1986).
59. *Shaffer*, 756 F. Supp. at 369 (citing *Mowbray*, 795 F.2d at 1117).
60. 756 F.Supp. 365 (N.D. Ill. 1991).
61. *Id.* at 369.

> The law has struggled to place a reasonable and predictable duty upon the third party who elects to perform this difficult task with its inherent potential for conflict.[62]

An escrow agent is a special or limited type of agent.[63] His or her authority is derived from and limited to that which is established by the agreement which created the escrow relationship.[64] The authority from this agreement is to be strictly construed and not extended beyond that which is expressly stated or that which is "necessary and proper to carry the authority given into full effect."[65]

The law has determined an escrow agent to be both agent and trustee.[66] The escrow agent's agency title pertains to the obligation and loyalty he owes to both parties, while the trustee title refers to the "performance of an express trust" with which he has been deposited.[67] The escrow agent, as an agent, owes some fiduciary duty to all parties of the agreement.[68] However, because of the adverse interests involved, "[i]t is unrealistic" to compare this duty to that of a trustee where multiple compatible interests exist or an agent where a single interest exists.[69] One court suggests that "to call [an escrow agent] an agent of the parties leads to confusion," and instead designated an escrow agent as a third party whom the principal parties have entrusted specific authority via an escrow agreement.[70]

Therefore, the duties owed by an escrow agent to the principal parties are of a limited nature.[71] At a minimum, an escrow agent's duty includes an obligation to exercise reasonable skill and ordinary diligence in following the escrow instructions.[72] There also exists a duty of loyalty, a duty to make full disclosure and a duty to exercise a high degree of care regarding the object/money held in escrow.[73] The duty of an escrow agent to disclose information to his/her

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62. SMP, Ltd. v. Syprett, Meshad, Resnick & Lieb, P.A., 584 So.2d 1051, 1053 (Fla. Dist. Ct. App. 1991) (court held that, absent specific provision in the escrow agreement, the escrow agent was under no duty to sell securities held in escrow per instruction of one party to the escrow).

63. Schoepe v. Zions First National Bank, 750 F. Supp. 1084, 1088 (D. Utah 1990), *aff'd*, 952 F.2d 1401 (10th Cir. 1992) (court held that bank acting as escrow agent for the sale of property had no duty to disclose to the vendor the fact that it had made loans to the purchaser).

64. *Schoepe*, 750 F. Supp. at 1088; *SMP, Ltd.*, 584 So.2d at 1054.

65. 30A C.J.S. *Escrows* § 10 (1987 & Supp. 1993).

66. *Id.*

67. *Id.*

68. *Schoepe*, 750 F. Supp. at 1088.

69. *SMP, Ltd.*, 584 So.2d at 1054.

70. *Id.* at 1054 (citing Nickell v. Reser, 57 P.2d 101, 103 (Kan. 1936)).

71. *See* 30A C.J.S. *Escrows* § 10 (1987 & Supp. 1993).

72. *Id.*

73. *Id.*; *SMP, Ltd.*, 584 So.2d at 1054 (there is duty to disclose all material facts but only those relevant to the agency, absent fraud).

principals[74] is limited to situations where such a duty is required by the escrow agreement,[75] where the information is regarding known fraud,[76] and where the information is regarding "material facts which might affect the principal's decision as to a pending transaction."[77] There is no common law duty of reasonable skill and ordinary diligence outside the realm of the escrow agreement.[78] Further, most courts have been "hesitant to hold escrow agents liable for the full panoply of fiduciary obligations."[79]

In contrast, there are courts which have attempted to expand the duties and liabilities of an escrow agent and to eradicate the distinction between an escrow agent and other agents.[80] The court in *Burkons v. Ticor Title Insurance Company of California*[81] expanded the escrow agent's duties to those of other agents and applied principles of agency.[82] *Burkons* imposed a standard on escrow agent's duties to be one of a "reasonable escrow agent" under the circumstances.[83] Critics of the *Burkons* Court, suggest that this objective standard is too imposing and that courts should not engage in determining the conduct of a reasonable escrow agent.[84]

The top of this pyramid of legal history leaves us with an array of semi-applicable case law on the topic of an escrow agent's ability to bind one of its principals, an investor in a securities transaction, to a contract containing an agreement to arbitrate with a third party clearing house. All of this case law is supported by logical reasoning and important policy concerns, however, none of it combines to answer the question at hand.

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74. Some courts have refused to enforce this duty because of the possible conflict in duty to each principal. *See* Lee v. Title Insurance & Trust Co., 70 Cal. Rptr. 378, 379 (Cal. Ct. App. 1968); Blackburn v. McCoy, 37 P.2d 153, 156 (Cal. Dist. Ct. App. 1934).

75. 30A C.J.S. *Escrows* § 10 (1987 & Supp. 1993); *SMP, Ltd.*, 584 F. Supp. at 1054.

76. Berry v. McLeod, 604 P.2d 610, 616 (Az. 1979).

77. *Schoepe*, 750 F. Supp. at 1089.

78. *SMP, Ltd.*, 584 So.2d at 1054.

79. Timothy J. Thomason & Linda B. Dubnow, *The Expanding Nature of the Escrow Agent's Duties; The Judicial Pendulum has Swung Too Far*, 25 ARIZ. ST. L.J. 643, 650 (1993).

80. *See* Burkons v. Ticor Title Insurance Company of California, 813 P.2d 710 (Az. 1991); National Bank of Washington v. Equity Investors, 506 P.2d 20 (Wash. 1973).

81. 813 P.2d 710 (Az. 1991).

82. *Id.* at 718 (citing W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS, § 106, at 738-39 (5th ed. 1984)).

83. *Burkons*, 813 P.2d. at 718.

84. Thomason, *supra* note 79, at 656.

IV. INSTANT DECISION

The *99 Commercial Street* court found that an agreement containing an arbitration clause signed by an escrow agent is sufficient to bind an investing customer.[85] The court's analysis consisted of an examination of the principles of arbitration, escrow, and agency law.[86]

A. Arbitration

The court reiterated its long-standing judicial predisposition favoring arbitration agreements[87] and held that such agreements are "valid, irrevocable, and enforceable."[88] However, the court also stated that parties are not required to arbitrate absent an express agreement.[89]

Next, the court held that general principles of contract and agency law are to be utilized in determining who is actually bound to an agreement to arbitrate.[90] Judge Sotomayor, writing the memorandum order, noted that an obligation to arbitrate does not attach merely by personal signature on an arbitration provision.[91] Further, the court stated that "ordinary contract principles determine who is bound by such written provisions" and how a "part[y] can become contractually bound absent their signature."[92]

B. Escrow

In this portion of the opinion, the court discussed ownership of escrow accounts.[93] First, the court restated Defendants' position that 99 Commercial Street owned the accounts when the Customer Agreement was signed, and also restated, Plaintiffs' assertion that the mortgagor, LCC, was the owner of the Escrow Account at the time of the agreement.[94] The *99 Commercial Street* court

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85. 811 F. Supp. at 907. The court first resolved secondary issues and held that GG & Co., as third party beneficiary, can move to compel arbitration under an agreement such as the one in question; and that the claims brought by Plaintiffs in this case are arbitrable if, in fact, 99 Commercial Street is a party to the arbitration agreement. *Id.* at 904. However, since these issues are resolved with no discussion of applicable law and are not pertinent to the primary issue involved in this case, they will not be dealt with in this Note.

86. *Id.* at 904.

87. *Id.*

88. *Id.* (citing *Moses H. Cone*, 460 U.S. at 24 (quoting the Federal Arbitration Act, 9 U.S.C. §2. (1947))).

89. *Id.* at 905 (citing Volt Information Sciences, Inc. v. Board of Trustees, 489 U.S. 468, 478 (1989)).

90. *Id.*

91. *Id.* (citing *Fisser* 282 F.2d at 233).

92. *Id.* (citing *Fisser*, 282 F.2d at 233).

93. *Id.*

94. *Id.*

held, however, that both parties are considered owners of the account regarding acts taken by the escrow agent according to the escrow agreement.[95]

After defining escrow as a written instrument entrusted to a third party agent by a grantor for delivery to a grantee after certain conditions are met and which is controlled by the escrow agreement,[96] the court discussed allocation of losses and ownership in an escrow situation.[97] Allocation of loss is determined by the timing of the incident causing the loss.[98] If the loss is suffered "before the condition for delivery is satisfied," it falls upon the grantor.[99] On the other hand, if the loss is incurred after the condition for delivery is satisfied, it falls on the grantee.[100] Further, following the deposit of the escrow and prior to the fulfillment of the condition, neither party retains control or ownership over it.[101] The court stated that "ownership is held in stasis."[102]

Finally, the court discussed an escrow agent's fiduciary duties under the principles of escrow law.[103] The court stated that an escrow agent "must follow the instructions of the parties,"[104] and "is bound to take whatever steps are necessary to fulfill its duties."[105] Judge Sotomayor stated that an escrow agent is an agent for, and on behalf of, both parties involved.[106] Finally, the court held that an agreement entered into by an escrow agent pursuant to the escrow agreement or the instructions of the parties is "valid and enforceable."[107]

C. Agency

In this third section of the decision, the court discussed the final question of whether it was within the escrow agent's duties and authority to bind Plaintiffs to the Customer Agreement.[108] The court found, according to general principles of agency, that an agent "with proper authority can enter into contracts with third persons on behalf of their principals."[109] Further, the court stated that, according to New York law, this authority can be express, implied or apparent if it is "reasonable from the circumstances surrounding the transaction."[110]

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95. *Id.*
96. *Id.*
97. *Id.* at 906.
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*.
103. *Id.*
104. *Id.* (citing Farago v. Burke, 186 N.E. 683, 684-85 (N.Y. 1933)).
105. *Id.* (citing Helman v. Dixon, 338 N.Y.S.2d 139, 142 (N.Y. Civ. Ct. 1972)).
106. *Id.*
107. *Id.* (citing 30A C.J.S. *Escrows* §10 (1987 & Supp. 1993)).
108. *Id.*
109. *Id.* (citing 2A C.J.S. *Agency* § 174 (1987 & Supp. 1993)).
110. *Id.*

From this analysis, the court reached the decision that the escrow agents in *99 Commercial Street* did act in accordance with their duties and bound all parties involved to the arbitration agreement which they signed.[111] Because Plaintiffs were aware that all monies involved would be sent through Bear Stearns for investment into the recommended funds and because a customer agreement containing an arbitration clause with the clearing house is not unusual in the ordinary course of a securities business, the court held that the acts of the escrow agents in executing the Customer Agreement were "eminently reasonable and fully within the scope of [their] duties."[112] According to Judge Sotomayer, the escrow agents had both express and apparent authority to act on behalf of and bind 99 Commercial Street to the Customer Agreement.[113]

V. COMMENT

The determination of this case rests on the issue of whether an escrow agent's powers should include the ability to bind one of its principals to an agreement containing an arbitration provision. The court's analysis was not fully reasoned to reach the correct decision on this issue. Although agreements to arbitrate are favored by public policy and should be encouraged, finding that a party is bound to such an agreement cannot be done without a thorough analysis of the circumstances surrounding the formation of the contract and a certain degree of specificity as to that party's intentions and expectations.

Historically, courts have held that agreements to arbitrate must be entered into with complete consent by both parties involved.[114] Consequently, courts cannot require a party to submit to arbitration absent a finding of such agreement.[115] Since courts use contract principals to interpret agreements to arbitrate, they may bind parties without an express agreement or signature. However, where this occurs, courts find some consent, through the use of contract principles, with which a party is bound to arbitrate disputes pursuant to agreement.[116] For example, courts have found the necessary consent in situations where: (1) there is a disclosed agent of one of the parties to the contract wishing to compel arbitration;[117] (2) a party intended by both principals to benefit from the performance of the contract as a third party beneficiary who wishes to compel arbitration;[118] (3) one of the parties to the contract containing the arbitration provision is a highly sophisticated commodities investor/customer

111. *Id.* at 907.
112. *Id.*
113. *Id.*
114. *Continental Group*, 873 F.2d at 617.
115. United Steelworkers v. Warrior and Gulf Navigation Co., 363 U.S. 574, 582 (1960); *McAllister Bros.*, 621 F.2d at 522.
116. *See supra* notes 47-53 and accompanying text.
117. *Nesslage*, 823 F.2d at 233.
118. Cauble v. Mabon Nugent and Co., 594 F. Supp. 985, 991 (S.D.N.Y. 1984).

who should have realized he would be bound to submit to arbitration;[119] (4) an action by an employee of a party to the agreement which is the subject of the arbitration constitutes an action of the principal;[120] and (5) there is a long term mutual reliance operated under with confidence that its terms would be enforced.[121]

In *99 Commercial Street*, however, the court is attempting to find consent through the actions of an escrow agent. This escrow agent's sole duty was to keep money while certain conditions were being resolved between a mortgagor and a mortgagee. Where the subject of an escrow agreement is specified and an escrow agent acts outside the scope of, or not in furtherance of that agreement, his actions should not be deemed as consented to by the parties to the escrow agreement.

In addition, some courts refuse to enforce contracts containing arbitration provisions signed by brokers for investors absent a greater showing that the investor intended to be bound.[122] These courts find that: (1) an arbitration provision is not "an 'obvious' (and hence, intended) incident" of a broker's powers;[123] (2) there is a lack of intent to allow a nonsignatory broker to enforce a contract containing such a provision;[124] or (3) there is a lack of intent to confer a benefit to a third party beneficiary.[125] Similarly, there is an absence of intent in *99 Commercial Street* to give the escrow agent the power to bind the investor to a contract containing an arbitration provision.

Resolving legal disputes by arbitration involves important procedural rights, or lack thereof, including the right to a trial. This right is relinquished if a party is forced to submit a dispute to arbitration. Courts are correct to search for some finding of intent to be bound, before allowing an escrow agent to relinquish such an important right on behalf of her principal. Therefore, a definite showing of intent should be required in any case containing a question as to whether there was an agreement to arbitrate, such as the case at hand.

Finally, and most importantly, escrow agents are different from other types of agents and should, therefore, be treated differently with respect to the powers which they possess.[126] The *99 Commercial Street* court gives an escrow agent the unlimited power to contract on behalf of its principals, which was probably never contemplated by either party. The duties owed by an escrow agent to a principal are and should be limited. Because of the nature of the agency relationship involved, an escrow agent's loyalties are divided between principals and the interests of each of those parties are often competing. For this reason, an escrow agent's duties to his principal are less than that of an ordinary agent. They

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119. *Id.*
120. *Scher*, 723 F. Supp. at 216.
121. *Okcuoglu*, 580 F.Supp. at 751.
122. *See supra*, notes 54-57 and accompanying text.
123. *Schaffer*, 756 F. Supp. at 369.
124. *Lester*, 676 F.Supp. at 484.
125. *Id.* at 485.
126. *See supra*, notes 58-75 and accompanying text.

are derived from, defined by, and limited to the escrow agreement and its corresponding instructions. Similar to his duties to a principal, an escrow agent's power to act on behalf of a principal should stem from the escrow agreement and/or the nature of the escrow. An escrow agent's powers, therefore, should be limited as well. Unless an action taken by an escrow agent on behalf of a principal is part of the specified escrow agreement or its correlating instructions, or is implicit in the nature of the escrow, it should be held to be outside of an escrow agent's powers. Where an important issue, such as binding a party to an agreement to arbitrate a dispute, is involved, unauthorized and unintended escrow agent actions should not be binding on the principal parties.

VI. CONCLUSION

Undeniably, agreements to arbitrate disputes should be encouraged and supported. However, the interpretation of an agreement to arbitrate and an action to compel arbitration on a party involved in a dispute, who is a nonsignatory to the agreement is a delicate issue involving a possible loss of procedural rights. Here, this issue is also complicated by an action on behalf of one of the parties by an agent who, arguably, does not possess such authority to act. The court did not make a sufficient inquiry into these issues, particularly the limited powers of escrow agents which is necessary to hold that escrow agents possess the power to bind parties to arbitration agreements. The holding in this case not only defies the theory that a party should not be bound to arbitrate without agreement; it could dangerously lead to an empowerment of an escrow agent to act for a principal in any capacity despite the inherent limitations of an escrow agent's authority.

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