IN THE SUPREME COURT OF TEXAS

No. 04-0865

IN RE MERRILL LYNCH TRUST COMPANY FSB, MERRILL LYNCH LIFE INSURANCE COMPANY, AND HENRY MEDINA, RELATORS

ON PETITION FOR WRIT OF MANDAMUS

Argued March 23, 2005

JUSTICE HECHT, joined by JUSTICE MEDINA, and joined by JUSTICE O'NEILL as to Part I, concurring in part and dissenting in part.

By agreeing to arbitrate all controversies with their broker, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"), Juan and Norma Alaniz also agreed to arbitrate claims against Merrill Lynch employees, including Henry Medina, for which Merrill Lynch could be liable because of the employment relationship. But Merrill Lynch cannot be held vicariously liable for Medina's actions, as it might ordinarily be, because the Alanizes have affirmatively disclaimed such liability. And the record does not establish whether Merrill Lynch would be obliged to indemnify Medina for any liability he might have to the Alanizes. Even if his actions as a financial analyst were generally within the course and scope of employment, it is not clear whether the same can be said for his recommendation of a transaction illegal under Texas law. The record provides no other basis for holding Merrill Lynch liable for Medina's actions or for the actions of its affiliates, Merrill Lynch Trust Co., FSB ("ML Trust") and Merrill Lynch Life Insurance Co. ("ML Life"), or for estopping the Alanizes from refusing to arbitrate their claims against those two companies. Accordingly, I

would hold that the lower courts correctly refused to compel arbitration of any of the Alanizes' claims.[1]

I agree that if some of the Alanizes' claims must be arbitrated and some litigated, litigation must be stayed pending the outcome of the arbitration. Thus, I concur only in Parts I, III-A, and IV of the Court's opinion.

I

For estate planning purposes, the Alanizes created an irrevocable trust, designating their descendants as beneficiaries and ML Trust as trustee, to purchase and hold a $5 million insurance policy on their lives. ML Trust bought the policy from ML Life with funds from the Alanizes' Merrill Lynch accounts. Nine years later, the Alanizes sued ML Trust and ML Life for self-dealing. The two companies concede that because they are affiliated,[2] the purchase of the policy was illegal under Texas law,[3] although they contend that they did not recognize the illegality at the time and that, in any event, the Alanizes benefitted from the transaction.

The Alanizes never agreed to arbitrate disputes with ML Trust and ML Life, but they did agree to arbitrate "all controversies" that might arise with Merrill Lynch.[4] Their financial advisor,

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[1] 159 S.W.3d 162 (Tex. App.—Corpus Christi 2004).

[2] MERRILL LYNCH & CO., THE MERRILL LYNCH 2004 FACTBOOK 12 – 13 (2005), http://www.ml.com/media/47195.pdf (last visited Aug. 22, 2007) (available in Clerk of Court's case file) (excerpting information from public filings and stating that Merrill Lynch Life Insurance Co. is a subsidiary of Merrill Lynch Insurance Group, Inc., which, along with Merrill Lynch Trust Co., FSB, are subsidiaries of Merrill Lynch Group, Inc., which, along with Merrill Lynch, Pierce, Fenner & Smith Inc., are subsidiaries of Merrill Lynch & Co., Inc.).

[3] TEX. PROP. CODE § 113.053(a)(1) (stating that with certain exceptions, "a trustee shall not directly or indirectly buy or sell trust property from or to . . . the trustee or an affiliate"); *id*. § 111.004(1)(A) (defining "affiliate" for purposes of the Texas Trust Code as "a person who directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person").

[4] The Alanizes' Cash Management Account Agreements with Merrill Lynch provided: "I agree that all controversies which may arise between us, including but not limited to those involving any transaction or the construction, performance, or breach of this or any other agreement between us, whether entered into prior, on or subsequent to the date hereof, shall be determined by arbitration." The agreements further specified that "'I,' 'me,' 'my' or 'accountholder' means each person who signs the CMA Application and Agreement form or the CMA SubAccount Application and Agreement form. 'You,' 'your' or 'MLPF&S' means Merrill Lynch, Pierce, Fenner & Smith Incorporated. . . ."

Medina, a Merrill Lynch employee, recommended the creation of the trust and the purchase of the ML Life policy. As a licensed insurance agent, Medina sold the policy to the trust and received compensation in addition to his Merrill Lynch salary. The Alanizes named Medina as a defendant in their suit against ML Trust and ML Life, but they did not name Merrill Lynch.

The Alanizes could not evade their arbitration agreement with Merrill Lynch simply by suing its employee, Medina, who was not a party to the agreement. An agreement to arbitrate disputes with someone necessarily includes claims against his agents if he can be held liable for those claims because of the agency relationship. The Court explained one reason for this rule last Term in *In re Vesta Insurance Group, Inc.*[5] A person cannot avoid his obligations merely because they must be discharged by an agent. For example, a company that has contracted to sell six widgets cannot renege on that contract because its shipping clerk, who would actually see that those widgets are sent to the buyer, did not also sign the contract. To allow a person to avoid an agreement to arbitrate disputes with someone by suing only the agents whose actions gave rise to the dispute but who did not sign the agreement would be to give arbitration agreements less effect than other agreements.[6]

Another reason for the rule is that a party should not be permitted to eviscerate his agreement to arbitrate disputes with a principal by establishing liability against the agent. As the Court explains, a principal's liability for his agent's action taken in the furtherance of the principal's business does not preclude action against the agent individually.[7] But establishing the agent's liability may be tantamount to establishing liability against the principal if the agent acted in the

[5] 192 S.W.3d 759 (Tex. 2006) (per curiam).

[6] *Id*. at 762 ("When contracting parties agree to arbitrate all disputes 'under or with respect to' a contract (as they did here), they generally intend to include disputes about their agents' actions because '[a]s a general rule, the actions of a corporate agent on behalf of the corporation are deemed the corporation's acts.' If arbitration clauses only apply to contractual signatories, then this intent can only be accomplished by having every officer and agent (and every affiliate and its officers and agents) either sign the contract or be listed as a third-party beneficiary. This would not place such clauses on an equal footing with all other parts of a corporate contract." (citations omitted)).

[7] *Ante* at ___ n.7 (citing authorities).

course and scope of his authority and the principal provided his defense. Further even if the claimant did not attempt to use a judgment against the agent to recover against the principal, the agent himself might be entitled to have the principal indemnify him for his liability.[8] In either situation, a party could effectively resolve the dispute that he had agreed to arbitrate with the principal by litigating with the agent.

So the Alanizes are bound to arbitrate with Medina any claims they have against Merrill Lynch. For example, they could allege that Medina was negligent or misleading in giving them financial advice. These claims would be arbitrable even if asserted against Medina only because they involve his conduct as a Merrill Lynch employee. But the Alanizes have tried very hard not to assert any such claims. Their original petition begins by complaining of Medina "in his capacity as an agent of Merrill Lynch Trust Company and Merrill Lynch Life Insurance Company", not as a Merrill Lynch employee. The petition alleges that ML Trust "as trustee used the trust funds to illegally engage in self-dealing by purchasing a life insurance policy from its own affiliate [ML Life] through its agent Henry Medina." Parts of the petition can be read in isolation to assert claims against Medina beyond his actions on behalf of ML Life and ML Trust. For example, the petition alleges generally that "Defendants", Medina included, breached their fiduciary duties, were negligent, and made negligent misrepresentations. But the Alanizes tell this Court that their "chief complaint" against Medina is "in his capacity as a licensed insurance agent for Life Insurance Company and sale of the insurance policy at issue."[9] Their "chief allegation", they say, is that ML Trust and ML Life

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[8] *See Oats v. Dublin Nat'l Bank*, 90 S.W.2d 824, 829 (Tex. 1936) (stating that "an agent, who in the performance of his duties for his principal incurs liability for an act not morally wrong, may have indemnity from the principal"); *Aviation Office of Am., Inc. v. Alexander & Alexander of Tex., Inc.*, 751 S.W.2d 179, 180 (Tex. 1988) (stating that this rule does not apply in negligence cases governed by the comparative responsibility statute); *see also Godwin v. Jessell*, No. 05-99-01824-CV, 2001 Tex. App. LEXIS 883, at *4-9 (Tex. App.–Dallas 2001, no pet.) (concluding that while "there is little case law defining the term 'morally wrong' acts," knowing dishonesty, misrepresentation, and deceit were, as a matter of law, among them).

[9] Responsive Brief of the Real Parties in Interest at 11.

engaged in self-dealing.[10] They contend that "Medina's actions as a licensed insurance agent in the sale of a life insurance policy in Texas are irrelevant and unconnected to [Merrill Lynch and the CMA agreements]."[11] Merrill Lynch, they say, "is not a defendant in the lawsuit simply because it neither acted as trustee nor insurance salesman and thus cannot be legally responsible for the damages caused to [plaintiffs] for violations of the Texas Trust Code or Insurance Code."[12] Merrill Lynch, they continue, "has no potential liability for any of the claims in this case and [plaintiffs have] not alleged [that Merrill Lynch] engaged in any act or omission in connection with the trust or insurance policy" that is the basis of the suit.[13] The Alanizes' counsel told the trial court that if they sued Merrill Lynch on the claims they had asserted against ML Trust, ML Life, and Medina, it would be entitled to summary judgment. The reason the parent company "set up these three affiliated companies and made them distinct entities", he argued, is "[b]ecause they do distinctly different things". "[T]here's no evidence," he stated, "that my clients are attempting to hold [Merrill Lynch] liable for the acts of the trust company, the life insurance company, or Medina."

Whether one *can* serve two masters,[14] the law allows it and generally makes both employers liable for the agent's actions.[15] But nothing requires a third party injured by the agent to hold both employers responsible. Ordinarily, the claimant has every reason to do so, if not simply to assure full recovery, then to keep each employer from escaping liability by blaming the other. But the

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[10] *Id*. at 11.

[11] *Id*. at 34.

[12] *Id*. at 18.

[13] *Id*. at 53.

[14] *Matthew* 6:24 ("'No one can serve two masters. Either he will hate the one and love the other, or he will be devoted to the one and despise the other. You cannot serve both God and Money.'").

[15] *See* RESTATEMENT (SECOND) OF AGENCY § 226 (1958) ("A person may be the servant of two masters, not joint employers, at one time as to one act, if the service to one does not involve abandonment of the service to the other."), *cited in Garza v. Excel Logistics, Inc.*, 100 S.W.3d 280, 284 (Tex. App.–Houston [1st Dist.] 2002), *rev'd on other grounds*, 161 S.W.3d 473 (Tex. 2005); RESTATEMENT (THIRD) OF AGENCY § 7.03, reporters' note d (2).

Alanizes face another consideration. ML Trust and ML Life have conceded that they violated Texas law in the purchase and sale of the life insurance policy. Merrill Lynch, on the other hand, does not admit that it is liable to the Alanizes for that reason or any other. The Alanizes must still prove that ML Trust's and ML Life's actions caused damages, which defendants adamantly deny, but the Alanizes may consider that an easier burden than taking on Merrill Lynch. Regardless of their motivation, nothing prevents them from complaining of Medina's actions on behalf of ML Trust and ML Life while disclaiming any complaint about his action on behalf of Merrill Lynch. That is what the Alanizes have done. It is not merely artful pleading, as relators complain. The Alanizes have disclaimed liability by Merrill Lynch.

Because allegations in the Alanizes' petition can be read to assert claims other than self-dealing by ML Trust and ML Life, and the Alanizes have not stipulated under oath or in their pleadings that they assert no other claims, the Court concludes that the Alanizes' claims against Medina "are in substance claims against Merrill Lynch".[16] But I would not ignore the efforts to limit their complaints that the Alanizes *have* made. The Court views their disclaimer as ineffective because it is not iron-clad, and worries that the Alanizes could still pursue imposing liability on Merrill Lynch down the road. But any claim they make against Merrill Lynch must be arbitrated. Should the Alanizes prevail in this action, their recovery would not bind Merrill Lynch because it is not a party.

The Alanizes' arbitration agreement might nevertheless be circumvented if Merrill Lynch were obligated to indemnify Medina, because he is an employee, or ML Trust and ML Life, because they are affiliates, and a judgment against them were binding on Merrill Lynch. But nothing in the record suggests that Merrill Lynch has any obligation to indemnify its affiliates, and it is unclear whether it would be required to indemnify Medina, or whether his recommendation of an illegal

[16] *Ante* at ___.

transaction, despite his claimed innocence, is the sort of conduct for which he is not due indemnification.[17] Also, while the Court states that "[t]here is no question Medina was acting in the course and scope of his employment",[18] the only evidence comes from Medina and the Alanizes, who have every reason to think he was. Merrill Lynch has not been heard on the subject. For all we know, Merrill Lynch had a policy against recommending transactions like this one. The right to arbitration must be proved, not merely assumed.

It bears repeating that a party cannot avoid his agreement to arbitrate by suing the other party's employees instead of the employee himself. But that is not the case here. If Medina had acted only as a financial analyst employed by Merrill Lynch and not as a licensed agent selling insurance, the Alanizes would have no basis for a claim against him distinct from a claim against Merrill Lynch. But he played a separate role, for which he was separately compensated, and I would hold that the Alanizes, disavowing all claims against Merrill Lynch, can sue him separately in that role, as well as ML Trust and ML Life.

II

Estoppel sometimes requires a person to arbitrate even though he has not agreed to do so, as this Court observed just six months ago in *Meyer v. WMCO-GP, LLC*.[19] When, exactly, has been hard to define. Several years ago, the Eleventh Circuit stated:

> application of equitable estoppel is warranted when the signatory to the contract containing the arbitration clause raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract. Otherwise the arbitration proceedings between the two signatories

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[17] *Supra* note 8.

[18] *Ante* at ___.

[19] 211 S.W.3d 302, 305 (Tex. 2006) ("As a rule, arbitration of a claim cannot be compelled unless it falls within the scope of a valid arbitration agreement. But sometimes a person who is not a party to the agreement can compel arbitration with one who is, and vice versa." (footnotes omitted)).

> would be rendered meaningless and the federal policy in favor of arbitration effectively thwarted.[20]

The Fifth Circuit endorsed this view in *Grigson v. Creative Artists Agency*,[21] and we referred to it as "substantially correct" in *Meyer*.[22]

The Court criticizes estoppel based on "substantially interdependent and concerted misconduct" because the theory "is far from well-settled in the federal courts."[23] The Court seems to think that the federal courts may be right in finding estoppel when arbitrable and nonarbitrable claims are "intertwined" as long as there is a "close relationship" component,[24] but the Court asserts that *Grigson* does not have that component. It is not at all clear to me that *Grigson*'s second prong is much different from the rule for intertwined claims applied in other cases that the Court accepts, but the issue need not be decided here. The Alanizes' claims against ML Trust and ML Life, as I have described them above, focus solely on the illegality of the inter-affiliate purchase and sale of the life policy. These claims are not intertwined with any claims that the Alanizes' might have against Merrill Lynch (which they have disavowed); they are not "substantially interdependent," do not have a "close relationship", and do not allege "concerted misconduct". No estoppel theory prohibits the Alanizes from refusing to arbitrate the claims it has asserted in the circumstances of this case.

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The Alanizes are not required to arbitrate their claims. I would accordingly deny mandamus relief.

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[20] *MS Dealer Serv. Corp. v. Franklin*, 177 F.3d 942, 947 (11th Cir. 1999) (citations, ellipses, brackets, and quotation marks omitted).

[21] 210 F.3d 524, 527 (5th Cir. 2000).

[22] *Meyer*, 211 S.W.3d at 306-308.

[23] *Ante* at ___.

[24] *Ante* at ___.

Nathan L. Hecht

Opinion delivered: August 24, 2007