

Third Circuit Compels Arbitration of Fraud in the Inducement Claim

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Reinsurance Alert

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In *South Jersey Sanitation Co., Inc. v. Applied Underwriters Captive Risk Assurance Co., Inc.*, No. 1-13-cv-06717 (Oct. 25, 2016), the Third Circuit held that when a contract contains a broad arbitration clause, any allegations of fraud in the inducement of the contract generally are to be addressed by the arbitrator rather than by the court. The dispute between South Jersey Sanitation Company (South Jersey) and Applied Underwriters Captive Risk Assurance Company (Applied Underwriters) arose after South Jersey refused to pay premiums allegedly owed pursuant to a Reinsurance Placement Agreement (RPA) between the parties.

The RPA contained an arbitration provision, which stated that any disputes arising under the contract will be arbitrated. The RPA also contained a choice of law provision, which stated that Nebraska law applies to any dispute arising out of the agreement. On October 31, 2013, South Jersey filed a complaint against Applied Underwriters in New Jersey Superior Court, seeking declaratory relief and rescission of the RPA on several grounds, including fraud, intentional misrepresentation and illegality. In response, Applied Underwriters removed the case to the U.S. District Court for the District of New Jersey and filed a motion to compel arbitration in accordance with the FAA. The District Court denied Applied Underwriters' motion to compel arbitration, arguing that a Nebraska statute, which provides that all arbitration provisions concerning or relating to an insurance policy are unenforceable, preempts the FAA.

Applied Underwriters appealed, arguing that the District Court erred in reaching the issue of preemption without first considering whether arbitration is a question for the courts or the arbitrator. Applied Underwriters argued further that the arbitrability of a claim for fraud in the inducement of a contract generally is a question to be addressed by an arbitrator rather than by the court. The Third Circuit agreed, citing two Supreme Court decisions, *Rent-A-Ctr., W., Inc. v. Jackson*, 561 U.S. 63 (2010) and *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), which held that, when a contract contains an arbitration provision, the court can only adjudicate claims for fraud in the inducement of the arbitration clause *itself*, and cannot consider claims for fraud in the inducement of the contract generally.

The Third Circuit's decision is significant because it emphatically reinforces Supreme Court precedent on this issue, making it expressly clear to parties doing business within the court's jurisdiction that if a contract contains an arbitration provision, the court can only consider challenges to the legal validity of the arbitration provision. As such, any challenges to the legal validity of the contract as a whole can only be adjudicated by the arbitrator. The court also held that it was unclear whether the Nebraska statute precluding arbitration applied to the RPA, and any dispute regarding the scope of the RPA was therefore an issue for the arbitrator to decide.

If you have questions or would like additional information, please contact Daryn Rush (rushd@whiteandwilliams.com; 215.864.6360), Zachery Roth (rothz@whiteandwilliams.com; 215.864.6274) or another member of our Reinsurance Group.

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