RECORD NUMBER: 19-1158(L), 19-1170, 19-1171

IN THE

United States Court of Appeals

FOR THE FOURTH CIRCUIT

BERKELEY COUNTY SCHOOL DISTRICT,

Plaintiff-Appellee,

v.

HUB INTERNATIONAL LIMITED; HUB INTERNATIONAL MIDWEST LIMITED,

Defendants-Appellants,

and

HUB INTERNATIONAL SOUTHEAST; KNAUFF INSURANCE AGENCY, INC.; STANLEY J. POKORNEY; SCOTT POKORNEY, BRANTLEY THOMAS,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA AT CHARLESTON

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UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
DISCLOSURE OF CORPORATE AFFILIATIONS AND OTHER INTERESTS

Disclosures must be filed on behalf of all parties to a civil, agency, bankruptcy or mandamus case, except that a disclosure statement is **not** required from the United States, from an indigent party, or from a state or local government in a pro se case. In mandamus cases arising from a civil or bankruptcy action, all parties to the action in the district court are considered parties to the mandamus case.

Corporate defendants in a criminal or post-conviction case and corporate amici curiae are required to file disclosure statements.

If counsel is not a registered ECF filer and does not intend to file documents other than the required disclosure statement, counsel may file the disclosure statement in paper rather than electronic form. Counsel has a continuing duty to update this information.

No. 19-1158 Caption: Berkeley County School District v. Hub International Limited

Pursuant to FRAP 26.1 and Local Rule 26.1,

Hub International Limited
(name of party/amicus)

who is appellant, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☑ YES ☐ NO
If yes, identify all parent corporations, including all generations of parent corporations:
Hub International Limited is owned by Hockey Intermediate Inc., which is in turn owned by Hockey Parent Inc., which is in turn owned by Hockey Parent Holdings L.P.

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(a)(2)(B))? ☐ YES ☑ NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐ YES ☑ NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐ YES ☑ NO
If yes, identify any trustee and the members of any creditors' committee:

Signature: /s/ Thomas J. Wiegand Date: March 26, 2019

Counsel for: Hub International Limited

CERTIFICATE OF SERVICE

****

I certify that on March 26, 2019 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below:

/s/ Thomas J. Wiegand
(signature)

March 26, 2019
(date)

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
DISCLOSURE OF CORPORATE AFFILIATIONS AND OTHER INTERESTS

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If counsel is not a registered ECF filer and does not intend to file documents other than the required disclosure statement, counsel may file the disclosure statement in paper rather than electronic form. Counsel has a continuing duty to update this information.

No. 19-1158 Caption: Berkeley County School District v. Hub International Limited

Pursuant to FRAP 26.1 and Local Rule 26.1,

Hub International Midwest Limited
(name of party/amicus)

who is appellant, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☑ YES ☐ NO
If yes, identify all parent corporations, including all generations of parent corporations:
Hub International Midwest Limited is owned by Hub International U.S. Holdings Inc., which is in turn owned by Hub International Limited, which is in turn owned by Hockey Intermediate Inc., which is in turn owned by Hockey Parent Inc., which is in turn owned by Hockey Parent Holdings L.P.

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(a)(2)(B))? ☐ YES ☑ NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐ YES ☑ NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐ YES ☑ NO
If yes, identify any trustee and the members of any creditors' committee:

Signature: /s/ Thomas J. Wiegand Date: March 26, 2019

Counsel for: Hub International Midwest Limited

CERTIFICATE OF SERVICE

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I certify that on March 26, 2019 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below:

/s/ Thomas J. Wiegand
(signature)

March 26, 2019
(date)

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
DISCLOSURE OF CORPORATE AFFILIATIONS AND OTHER INTERESTS

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Corporate defendants in a criminal or post-conviction case and corporate amici curiae are required to file disclosure statements.

If counsel is not a registered ECF filer and does not intend to file documents other than the required disclosure statement, counsel may file the disclosure statement in paper rather than electronic form. Counsel has a continuing duty to update this information.

No. 19-1170 Caption: Berkeley County School District v. Hub International Limited, et al

Pursuant to FRAP 26.1 and Local Rule 26.1,

Scott Pokorney
(name of party/amicus)

who is Defendant - Appellant, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☐ YES ☑ NO
If yes, identify all parent corporations, including all generations of parent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(a)(2)(B))? ☐ YES ☑ NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐ YES ☑ NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐ YES ☑ NO
If yes, identify any trustee and the members of any creditors' committee:

Signature: s/ Robert H. Jordan Date: 02/26/2019

Counsel for: Scott Pokorney

CERTIFICATE OF SERVICE

****

I certify that on Feb. 26, 2019 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below:

s/ Robert H. Jordan 02/26/2019
(signature) (date)

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
DISCLOSURE OF CORPORATE AFFILIATIONS AND OTHER INTERESTS

Disclosures must be filed on behalf of all parties to a civil, agency, bankruptcy or mandamus case, except that a disclosure statement is **not** required from the United States, from an indigent party, or from a state or local government in a pro se case. In mandamus cases arising from a civil or bankruptcy action, all parties to the action in the district court are considered parties to the mandamus case.

Corporate defendants in a criminal or post-conviction case and corporate amici curiae are required to file disclosure statements.

If counsel is not a registered ECF filer and does not intend to file documents other than the required disclosure statement, counsel may file the disclosure statement in paper rather than electronic form. Counsel has a continuing duty to update this information.

No. 19-1171 Caption: Berkeley County School District v. Hub International Limit, et al

Pursuant to FRAP 26.1 and Local Rule 26.1,

Stanley J. Pokorney
(name of party/amicus)

who is Defendant/Appellant, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☐ YES ☑ NO
If yes, identify all parent corporations, including all generations of parent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(a)(2)(B))? ☐ YES ☑ NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐ YES ☑ NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐ YES ☑ NO
If yes, identify any trustee and the members of any creditors' committee:

Signature: s/Deborah B. Barbier Date: 2/26/2019

Counsel for: Stanley J. Pokorney

CERTIFICATE OF SERVICE

****

I certify that on 2/26/2019 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below:

s/Deborah B. Barbier (signature) 2/26/2019 (date)

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INTRODUCTION

This appeal concerns the district court's denial of a motion to compel arbitration pursuant to the Federal Arbitration Act, 9 U.S.C. § 1, *et seq*. ("FAA").

The Berkeley County School District ("District") filed a Complaint against a number of defendants based on their alleged participation in a kickback scheme orchestrated by the District's former Chief Financial Officer, Brantley Thomas. The District alleges that Thomas took kickbacks in return for steering the District toward unnecessary insurance policies and related services brokered through certain of Hub International Limited's affiliate and predecessor companies. Among other things, the District's original Complaint alleged that it had "entered into multiple contracts with the Insurance Defendants for consulting services," JA62-63 ¶234; asserted claims under South Carolina law for breach of those contracts, *see id.* ¶¶233-36; and sought some $14 million in damages based on the amounts the District paid pursuant to those contracts, JA65.

It turns out, however, that several of the contracts the District invoked as the basis for its claims—so-called "Brokerage Service Agreements"—contain broad arbitration clauses. The defendants sought to enforce their rights under the contracts, moving under the FAA to compel arbitration of the District's claims and to stay the district court litigation. The District promptly attempted to reverse course. It filed an Amended Complaint that dropped the cause of action for breach

of contract. And it suddenly denied that the contracts it previously represented it had entered into with the Hub entities had ever been formed. But the theories underlying the District's claims—including the damages it seeks—still presume the contracts' existence and the parties' performance under them.

The district court denied arbitration. The Complaints allege, and the district court acknowledged, that Thomas's duties as CFO included procuring insurance services for the District. But the court concluded that the District was not bound by Thomas's actions in accepting and performing under the Brokerage Service Agreements on the District's behalf because Thomas was motivated to obtain kickbacks. As a result, the court held, the contracts containing the arbitration clauses never were formed.

That decision should be reversed, for a host of reasons. First, it is inconsistent with South Carolina agency law, which provides that a principal is bound even by unlawful, unauthorized, and self-serving actions of its agent, so long as the agent's conduct is in the course of his official duties. Second, the court exceeded its authority under the FAA by deciding issues that hinged on disputed factual questions without conducting an evidentiary hearing. Third, it failed to support the key conclusions underpinning its decision with any evidence. Indeed, while the contracts containing the arbitration clauses dated back to 2002, there was no allegation—much less evidence—that Thomas had taken a kickback before 2013.

And fourth, the court should not even have reached the issue in the first place. While framed as an issue of agency law, the allegations actually sound in fraudulent inducement. Under Supreme Court precedent, an argument that the underlying contract containing an arbitration agreement was induced by fraud must be decided by the arbitrators—not the court.

JURISDICTIONAL STATEMENT

The Amended Complaint asserts claims under the federal Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961, *et seq.*, and South Carolina state law. *See* JA45-65 ¶¶158-245; JA163-196 ¶¶161-303. The district court had federal-question jurisdiction over the RICO claim under 28 U.S.C. § 1331, and supplemental jurisdiction over the state-law claims under 28 U.S.C. § 1367(a). The district court entered an order denying defendants-appellants' motions to compel arbitration and stay litigation on January 29, 2019. JA358-386. The Hub Defendants timely appealed on February 8, 2019, JA387-388; Scott Pokorney timely appealed on February 11, 2019, JA389; and Stanley Pokorney timely appealed on February 11, 2019, JA390. This Court has jurisdiction under 9 U.S.C. § 16(a)(1)(A) and (a)(1)(B).

STATEMENT OF ISSUES

1. Whether the district court committed legal error under South Carolina agency law in concluding that the District was not bound by the actions of Thomas, its CFO, in procuring insurance services from the Hub Defendants.

2. Whether the district court exceeded its authority under the FAA by deciding disputed questions of fact without conducting the "trial" required by 9 U.S.C. § 4.

3. Whether the district court's holding that the District never entered into the Brokerage Service Agreements, and therefore is not bound by the arbitration agreements they contain, can be sustained where the court's key findings are unsupported by record evidence.

4. Whether the District's argument for avoiding arbitration—that it is not bound by the Brokerage Service Agreements because they allegedly were procured pursuant to a kickback scheme—sounds in fraudulent inducement, and the issue thus should have been reserved for the arbitrators to decide.

STATEMENT OF THE CASE

I. THE DISTRICT'S ORIGINAL COMPLAINT

In January 2018, the Berkeley County School Board of Trustees, the governing body of the Berkeley County School District, filed a Complaint alleging that its own former Chief Financial Officer, Brantley Thomas, engaged in a long-running, "pervasive scheme of corruption" to enrich himself at the District's

expense. JA12.[1] The Complaint relied heavily on a criminal Information filed by the U.S. Attorney for the District of South Carolina, and an Indictment handed down by a South Carolina grand jury, charging Thomas with myriad crimes. *See, e.g.*, JA13, JA18-21. The Complaint invokes a variety of "nefarious acts committed by [Thomas] while he was the District's CFO," JA14, but the vast majority of Thomas's acts have nothing to do with this case. For example, federal prosecutors alleged that Thomas embezzled $450,000 from the District. JA199-200 ¶¶9-10. The South Carolina grand jury similarly charged Thomas with embezzlement and forgery crimes involving about a half-million dollars. JA207-222. Thomas has pleaded guilty to those crimes. JA170 ¶¶190, 193. None of that is relevant here.

The federal Information did, however, also charge Thomas with several counts of "honest services wire fraud" for "steer[ing] [the District's] insurance policy purchases through a broker employee" in exchange for "cash kickbacks from that employee." JA202 ¶17. Those allegations formed the basis of the District's Complaint. The Complaint alleges that the broker employee who acted with Thomas is Stanley Pokorney, an insurance broker who worked for Knauff

[1] The Hub Defendants pointed out that the School Board was not the proper plaintiff under South Carolina law, *see* Dkt. 19 at 4, and the District ultimately was substituted as the plaintiff in an Amended Complaint, *see* JA128. For simplicity, we refer to the plaintiff as the "District" when describing both the original and amended complaints.

Insurance Agency, Inc. ("Knauff"), and later for Hub International Midwest Limited after it acquired Knauff in 2012. JA12; JA16 ¶¶7-8; *see* JA129; JA133 ¶¶6-7. The crux of the allegations is that Stanley Pokorney recommended unnecessary insurance policies, as well as insurance brokering and consulting services, which Thomas caused the District to purchase in exchange for kickbacks. JA12-13; *see* JA129-130. The Complaint named as defendants Thomas, Stanley Pokorney and Scott Pokorney (the latter of whom was alleged to have played a role in the later years of the scheme), Knauff, Hub International Limited, and Hub International Midwest Limited. *See, e.g.*, JA16-17 ¶9; JA34 ¶¶94-97; JA133 ¶8; JA152 ¶¶100-101.[2]

According to the original Complaint, the defendants had been engaged in a kickback scheme "since at least 2001." JA19 ¶21. The District alleges that, as a result of the scheme, it (1) purchased insurance policies in areas including Builder's Risk, Student Accident, Excess Crime, Cyber, Excess General Liability, Directors and Officers Liability, Inland Marine, and Errors and Omissions coverage for Board members, JA23 ¶40; JA141 ¶44, and (2) paid various consulting and brokerage fees, JA24-25 ¶¶44-46; JA142-143 ¶¶48-50. The District alleges that Thomas steered it into purchasing those insurance policies and

[2] We refer to Knauff and the Hub entities as the "Hub Defendants." Excluding Thomas, we refer to all of the defendants collectively as the "Insurance Defendants."

services in exchange for "kickbacks in the form of cash, expensive hotel accommodations and dinners, and elaborate spa treatments." JA12; JA129.

Notwithstanding the Complaint's allegation that the scheme began in 2001, the only cash kickbacks identified were a series of $2,000 checks between February 2013 and November 2016 that were alleged in the federal Information—a total of $32,000. JA18-19 ¶¶17-18; JA30 ¶74; JA31 ¶78, JA34 ¶95; JA35 ¶98; JA136-137 ¶¶21-22; JA148 ¶78; JA149 ¶82; JA152 ¶99, JA153 ¶102; JA203-204 ¶23. And the only alleged provision of hotel accommodations, dinner, or spa treatments relates to one dinner in April 2015 and another meeting in August 2016. JA34 ¶96; JA44-45 ¶¶152-153; JA152 ¶100; JA162 ¶¶156-157.

The District's Complaint stands in stark contrast to the criminal Information in critical respects. The only thing the Information alleged that the "citizens of Berkeley County" were "depriv[ed]" of as a result of the scheme was "their intangible right to [Thomas's] honest services as the Berkeley County School District Chief Financial Officer." JA202 ¶14. It alleged that Thomas had "***steered*** [the District's] insurance policy purchases" to a particular broker in exchange for kickbacks. *Id.* ¶17 (emphasis added). It nowhere suggested that the brokerage services and insurance policies were unnecessary or that the District would not otherwise have purchased them from another broker absent the alleged kickbacks.

The District, by contrast, seeks to leverage Thomas's self-dealing as an opportunity to recover from the Insurance Defendants every penny it paid for insurance premiums and brokerage and consulting services during certain periods. The original Complaint sought to recover all such amounts paid from 2001 through 2017—a total of $14,183,406.60. *See* JA24-25 ¶¶44-47; JA65; *see also* JA142-143 ¶¶48-51 (Amended Complaint with same theory but starting in 2005). The premise of the Complaint is that every policy Thomas purchased for the District in that 16-year span was entirely unnecessary, had zero value to the District, and would not have been procured from any private company absent the alleged scheme. *See, e.g.*, JA25 ¶¶46-48, 200; JA183 ¶248. The District alleged that it already had sufficient coverage under general tort liability and property and casualty policies it procured through the South Carolina Insurance Reserve Fund ("IRF"), a governmental insurance operation. JA22-25 ¶¶33-47; JA139-141 ¶¶37-42, 45. It so alleged even though the Complaint elsewhere makes clear that it previously had been purchasing some of the very same policies from a completely different private broker for years before it began doing so through the Hub Defendants. *See* JA34 ¶¶91-93; JA151-152 ¶¶95-97.

The Complaint alleged violations of the federal RICO Act, as well as breach of contract and nine other causes of action under South Carolina law. *See* JA45-65

¶¶158-245. It sought to treble its purported damages of $14,183,406.60, for a total of $42,550,218.00. JA65.

II. THE INSURANCE DEFENDANTS MOVE TO COMPEL ARBITRATION

A. The Contracts Forming the Basis of the District's Claims Contain Arbitration Agreements

The insurance services that the District claims were fraudulently procured were provided pursuant to contracts. As the original Complaint explained, the District had "entered into multiple contracts with the Insurance Defendants for consulting services," which it alleged "required Defendants to use their expertise as insurance consultants to provide sound advice concerning the insurance needs of the District." JA62-63 ¶234. The Complaint alleged that the defendants had "breached their contracts with the District by providing unsound advice, and advising the District to purchase insurance that was unnecessary and excessive, for the sole purpose of allowing the Insurance Defendants to charge exorbitant broker's and consultant's fees." JA63 ¶235. The District sought $14 million in damages based on the amounts it paid pursuant to those contracts. *Id.* ¶236.

The Complaint did not attach the contracts that formed the basis of its breach-of-contract claims. But a number of those contracts—"Brokerage Service Agreements" between the District and Knauff—contained clear arbitration provisions:

> ***All*** disputes, claims or controversies ***relating to this Agreement, or the services provided***, which are not otherwise settled, ***shall*** be submitted to a panel of three arbitrators and resolved by final and binding arbitration, to the exclusion of any courts of laws, under the commercial rules of the American Arbitration Association.
>
> . . .
>
> Judgment upon the award rendered may be entered in any court having jurisdiction thereof; however, the arbitrators may not enter an award for damages in excess of the actual compensatory damages sustained, nor make any award for punitive damages. Each party shall bear the expense of its own arbitrator and shall jointly and equally bear with the other party the cost of the third arbitrator and of the arbitration.

E.g., JA91-92 ¶¶4.4, 4.5 (emphasis added).[3]

Of the copies of those agreements located in the Hub Defendants' files, the 2002 and 2003 agreements were signed by District employees Angel Cartwright and Brantley Thomas, respectively. JA92; JA97. The copies of the remaining four agreements in Hub's files were not signed by the District, and a District employee has declared that she could not locate them in the District's files. JA124-125 ¶4. But the District's own pleadings show that it made payments to Knauff for the exact services, and for the exact prices, specified in those contracts.

For example, a 2009 Brokerage Service Agreement, renewed in 2010 and 2011, offered "Directors and Officers Liability" insurance for the nonprofit organization Securing Assets for Education ("SAFE") affiliated with the District. JA113

[3] *See also* JA96-97 (same); JA101-102 (same); JA106-107 (same); JA114-115 (same); JA121-122 (same).

¶2.1. That contract specifies a brokerage service fee of $118,625, *id.*, and includes the arbitration provision, JA114-115. The District alleges that it purchased Directors and Officers Liability policies, JA141 ¶44, and paid "a consultant's fee for this coverage in the amount of $118,625.00," JA154 ¶110. Financial records attached to the operative complaint also show that the District made three payments to Hub in that exact amount in December 2009, December 2010, and December 2011—each of which was labeled "Brokerage Service Fees SAFE" or "Brokerage Fee _SAFE." JA245.

The same is true of the parties' 2011 agreement for services related to the District's School Leaders Errors & Omissions Liability Coverage ("E&O"). That agreement offered those services for a $70,000 annual fee, JA120 ¶2.1, and was accompanied by an April 25, 2011 cover letter memorializing the offer and the agreed-upon payment terms, JA117-118. The District alleges that "from 2010 through 2016," it "paid broker's fees" for a School Board Errors & Omissions policy. JA160 ¶147. And it asserts that Hub "began charging the District with a broker's fee for the E&O policy at $70,000.00 per year." *Id.* ¶146. The District's financial records also show that it made a $70,000 payment labeled "Brokerage Fee for Multi-Year E&O Coverage" on April 25, 2011, JA245—the same date as the cover letter attached to that contract, JA117-118.

The contracts containing these arbitration agreements pertain to insurance policies and services at the heart of this lawsuit. For example, the District has alleged that the Hub Defendants improperly advised it to purchase Inland Marine, Excess Liability, E&O, and Directors and Officers coverage. *See* JA23 ¶40, JA36-37 ¶¶104-112, JA37-40 ¶¶113-126, JA40-42 ¶¶127-139, JA42-43 ¶¶140-146 (Complaint); JA141 ¶44, JA154-155 ¶¶108-116, JA155-158 ¶¶117-130, JA 160-161 ¶¶144-150 (Amended Complaint). All four of those policies were included in Brokerage Service Agreements that the parties entered in 2003, 2006, 2009, and 2011—each of which contained the arbitration provision. *See* JA96-97; JA106-107; JA114-115; JA121-122.

B. The Insurance Defendants Move To Compel Arbitration Pursuant to the Brokerage Service Agreements

In March 2018, the Hub Defendants filed a motion to enforce the arbitration agreements in the Brokerage Service Agreements and correspondingly to stay the district court litigation under Sections 3 and 4 of the FAA. JA66-82. Defendants Scott Pokorney and Stanley Pokorney joined in that motion. Dkts. 29, 35.

The Hub Defendants urged that the District's claims were subject to the broad arbitration agreements discussed above. JA71-73.[4] A "significant relation-

[4] The Hub Defendants could invoke those agreements as Knauff's successors-in-interest and under established law permitting a third party to compel arbitration where the claims of a party to an arbitration agreement "'either literally or obliquely[] assert a breach of duty created by the contract containing the

ship" existed between each claim and the contracts containing the arbitration provisions. JA75. Indeed, the Complaint alleged a unitary course of fraudulent conduct over a period of sixteen years regarding ***all*** business between the Insurance Defendants and the District. JA75-77.

The Hub Defendants anticipated that the District would challenge the scope and validity of the arbitration agreements. They explained, however, that because the agreements incorporate the Commercial Rules of the American Arbitration Association—which expressly delegate to the arbitrators "objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim"—any issues as to whether and to what extent the arbitration agreements could be enforced had to be decided by the arbitrators, not the court. JA78-79; *see Simply Wireless, Inc. v. T-Mobile US, Inc.*, 877 F.3d 522, 526-28 (4th Cir. 2017), *abrogated on other grounds by Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct 524 (2019).

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arbitration clause.'" JA73-74 (quoting *Am. Bankers Ins. Grp., Inc. v. Long*, 453 F.3d 623, 629 (4th Cir. 2006)). That was the case here because the District sought to hold the defendants liable for breaches of contracts that contained the arbitration clauses, and because other claims alleged violations of duties arising from or relating to those contracts. *See* JA74-75. For similar reasons, Stanley and Scott Pokorney urged that they could enforce the arbitration agreements as the agents of Hub and Knauff, and because the claims related to services provided in connection with the asserted contracts. *See* Dkts. 29, 35.

III. THE DISTRICT'S EFFORTS TO AVOID ARBITRATION

A. The District's Amended Complaint

In response to the arbitration motions, the District simultaneously filed an Amended Complaint along with a brief in opposition. Dkts. 33, 36. The District's new pleading alleged the same scheme set forth in the original Complaint—indeed, the vast majority of its allegations are identical. But it made conspicuous changes that, as the district court later "agree[d]," reflected "'a thinly-veiled attempt to gerrymander the District's case' to circumvent the arbitration requirement in the Brokerage Service Agreements." JA374 n.6.

First, the Amended Complaint shortened the alleged scheme by four years to avoid the years covered by the signed Brokerage Service Agreements the Hub Defendants had submitted. The original Complaint alleged that Thomas and the Insurance Defendants engaged in a kickback scheme "[d]uring th[e] period" that Stanley Pokorney served as the District's insurance consultant broker (which began in 1993), and "at least since 2001." JA12; *see* JA19 ¶21. And it sought as damages all insurance premiums and fees it had paid dating back to that year. JA25 ¶47; JA65 (prayer for relief). The Amended Complaint changed the start date of the alleged scheme, and the corresponding damages period, to "at least since 2005." JA129; JA137 ¶25; JA196 (prayer for relief).

Second, the Amended Complaint dropped the express cause of action for breach of contract. But the new pleading still alleged that the scheme centered on Thomas "awarding insurance policy contracts and business to the Insurance Defendants," JA165 ¶171, and it still sought as damages amounts the District paid pursuant to the brokerage contracts and insurance policies, *see, e.g.*, JA176 ¶219.

B. The District's Opposition

The District's brief opposing the motions to compel arbitration essentially ignored the signed 2002 and 2003 agreements, arguing that they were no longer "relevant to this action in light of the [Amended] Complaint, which does not include the years during which those documents were supposedly in place." Dkt. 33 at 20. The District argued that it did not agree to the later arbitration agreements because "the District did not know the[y] . . . existed until the [Hub Defendants' arbitration] Motion was filed." *Id.* at 19. The only evidence cited in support was an employee's declaration that she had searched the District's records for copies of those agreements and they "ha[d] not been located." JA124-125 ¶4.

The District raised a laundry list of other arguments why the arbitration agreements should not be enforced. *See* Dkt. 33 at 16-29. Most relevant here, the District urged that Thomas "did not have authority to bind the District" contractually because he "was committing fraud for his own benefit and, as such, was acting outside the scope of his agency for the District." *Id.* at 26-27. That

argument, consisting primarily of a one-page string cite, was entirely conclusory. The District cited law stating that a principal may not be bound by an agent's actions where the agent acts "solely for the agent's own purposes." *Id.* at 26. But the District made no effort to explain, much less prove, how Thomas's purchase of insurance policies and services for the District in the course of his duties as CFO was "solely" for his own purposes, and provided ***no*** benefit to the District. *Id.*

IV. THE DISTRICT COURT DENIES ARBITRATION

The district court heard oral argument on May 17, 2018. On January 29, 2019, the court issued a decision denying the Insurance Defendants' arbitration motions. *See* JA358-386.

The district court's opinion included a lengthy analysis of "how a challenge to the validity of an arbitration clause under § 2 of the Federal Arbitration Act . . . is handled." JA365-380. It noted that the Hub Defendants had argued that, under the arbitration provisions in the contracts, the parties had agreed to delegate any disputes over the arbitrability of the claims to the arbitrators. JA363. The court, however, drew a distinction "between a challenge to the ***validity*** of the [arbitration] clause and a challenge to whether an agreement to arbitrate was ***formed*** in the first place." *Id.* (emphasis added). It concluded that "[w]hen a party disputes whether it agreed to the arbitration clause in the first place, as opposed to whether the

clause is valid, it is exclusively within the court's province to determine if an agreement to arbitrate was formed." JA368.

In the district court's view, the District had asserted both types of challenges. It stated that the District had asserted arguments that "go to the validity of the clause," including whether the arbitration clauses "violate South Carolina's procurement code" and whether "they were induced by fraud." JA380 n.9. Under the court's analysis, such arguments would be reserved for the arbitrators.

But the court also stated that the District had "argue[d] that it never agreed to arbitrate in the first place." JA380. The District had urged that "(1) some of the Brokerage Service Agreements are not signed by the District, and the District was unaware that the agreements existed until the motion to compel was filed; and (2) Thomas acted outside the scope of his agency when he entered into the Brokerage Service Agreements." *Id.* In view of that, the court stated that it "must look to South Carolina contract formation law to determine if the parties ever agreed to arbitrate in the first place, and in doing so, the court may look at the entirety of the Brokerage Service Agreements, not just the Arbitration Clauses within them." *Id.*

The court ultimately concluded that "the District did not agree to any of the Brokerage Service Agreements or the Arbitration Clauses within them." JA381.

Regarding the unsigned contracts, it accepted the District's representation that "it did not know they existed" before the motions to compel arbitration. JA382.

The court acknowledged that, signed or not, the District could have "accept[ed] an offer and form[ed] a contract through performance," such as by "paying the broker's and consultant's fees." JA382. But it refused to apply that "usual rule" to what it called "this most unusual set of facts." JA382-383. The court recognized that "[n]ormally, Thomas, as the Chief Financial Officer of the District, would have the authority to act on behalf of the District" and "bind[]" it to the Brokerage Service Agreements and the arbitration clauses they contained. JA384. But after "[c]onsidering the[] allegations" in the "amended complaint," the court accepted that Thomas acted "with the purpose of defrauding the District." JA383. Based on that, it was "unwilling to consider the District's payment of the broker's and consultant's fees as the District's acceptance of the Brokerage Services Agreements." JA383-384.

The court cited South Carolina law holding that if an employee "'acts for some independent purpose of his own, ***wholly disconnected*** from the furtherance of his employer's business,' then his conduct is outside the scope of his employment, and it will not be imputed to his employer." JA384-385 (emphasis added) (quoting *Vereen v. Liberty Life Ins. Co.*, 412 S.E.2d 425, 429 (S.C. Ct. App. 1991)). It did not, however, apply that "wholly disconnected" standard to the facts

before it. The court stated that Thomas's conduct was motivated by his desire to "receiv[e] kickbacks." JA385. But it cited no evidence, and made no finding, that purchasing insurance was "wholly disconnected" from furthering the District's business. The court further stated that Thomas "was not acting in furtherance of the District's business because the payments to the Insurance Defendants actually harmed the District." *Id.* But it cited no evidence in support of that conclusion. It made no finding that the insurance actually was unnecessary, or even that the services cost more than the District otherwise would have paid absent the alleged kickbacks to Thomas.

With regard to the agreement signed by Thomas, the court reasoned that he "was not acting within the scope of his employment," based on the same allegations. JA385. As to the agreement signed by Cartwright, the court "impute[d] her signature to Thomas" based on the District's counsel's assertion at oral argument that she "was an 'underling' of Thomas." *Id.* n.10. That conclusion stood in sharp contrast to the court's initial reaction to the same assertion. During the argument, the District's counsel had called Cartwright "a three- or four-step underling of Brantley Thomas," and the court responded: "Her signature still binds them. Within the course and scope of her employment." JA351 ll. 3-7.

For those reasons, the court held that the District "never agreed to the Brokerage Service Agreements or the Arbitration Clauses." JA386. And "[b]e-

cause there was no agreement to arbitrate," the court refused to "send the District's claims to arbitration." *Id.*

The Insurance Defendants timely appealed. JA387-388 (Hub Defendants); JA389 (Scott Pokorney); JA390 (Stanley Pokorney).

SUMMARY OF ARGUMENT

I. The district court committed legal error under South Carolina law in holding that the District was not bound by its CFO's purchase of insurance services. The law is clear that a principal is responsible for the acts of its agents within the scope of their employment—even if those acts are fraudulent or motivated by self-interest. An agent's motives take him outside the scope of his authority only when his actions are ***wholly disconnected*** from his job responsibilities—*i.e.*, where he acts ***solely*** for his own purposes and confers ***no benefit*** on the principal. The district court failed to apply that standard. It conceded that procuring insurance was among Thomas's duties, but held that the District could escape any insurance contracts that Thomas touched based on the grounds that Thomas acted "for the independent purpose of receiving kickbacks" and "harmed the District." JA385. Even if true, Thomas's self-dealing does not permit the District to avoid responsibility for Thomas's actions within the scope of his employment.

II.A. The district court also made a critical procedural error. When the existence of an arbitration agreement is contested, the FAA calls for an expeditious trial of the disputed factual issues. As with other factual issues turning on material outside the pleadings, a district court should first apply a standard akin to summary judgment, and then hold a trial to resolve any remaining disputes of material fact. Here, the parties' arguments largely focused on legal issues. And for its part, the District failed to offer evidence in support of its factual assertions; it rested on the allegations in its Amended Complaint. The district court nevertheless denied arbitration by making conclusions in the District's favor on disputed factual issues, without holding an evidentiary hearing that would require the District to support its position with proof and allow the Insurance Defendants the opportunity to counter with proof of their own. That denied the Insurance Defendants the process the FAA mandates.

B. The district court's resolution of disputed factual issues was not just procedurally improper; it also lacked any evidentiary basis. The court cited no record evidence in resolving crucial factual issues, instead relying on allegations, statements of counsel, and unwarranted suppositions. Most critically, the court held that the District could not be bound by the Brokerage Service Agreements because they were all tainted by kickbacks, despite there being ***no*** record evidence of a kickback during the relevant time period. The court made similarly unsup-

ported conclusions on other issues going to the heart of its decision denying arbitration.

III. The district court should not have even reached the issue that formed the basis for its decision denying arbitration. The court concluded that the District could not be held to the terms of the Brokerage Service Agreements because of the alleged kickback scheme. That argument, however, sounds in fraudulent inducement and would render the agreements voidable by the defrauded party; it is not an issue of contract formation that renders the agreements void *ab initio*. The argument, moreover, goes to the Brokerage Service Agreements as a whole—not to the arbitration agreements. Under longstanding Supreme Court precedent, such an argument should have been reserved for the arbitrators to decide.

ARGUMENT

The Federal Arbitration Act provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §2. Time and again, the Supreme Court has underscored the "emphatic federal policy in favor of arbitral dispute resolution" embodied in the FAA. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985); *see also, e.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 339 (2011). The district court here frustrated that "emphatic federal policy" by refusing to give effect to the Brokerage Service

Agreements between the Insurance Defendants and the District, which required that the District's claims be submitted to arbitration.

The district court's rationales for finding that "the District did not agree to any of the Brokerage Service Agreements or the Arbitration Clauses within them," JA381, do not withstand scrutiny. The court misconstrued South Carolina agency law in holding that Brantley Thomas, the District's CFO, lacked authority to bind the District notwithstanding that purchasing insurance was part of his job. Even if Thomas was a fraudster who sought to profit personally from the performance of his official duties, the law does not automatically relieve the District of its obligations under every contract he signed on its behalf.

The district court's decision also fails for procedural and evidentiary reasons. The District's brief opposing arbitration cited little evidence—and cited none on the agency issue the court found dispositive—resting instead on mere allegations in the Amended Complaint. Yet the district court made sweeping conclusions with regard to critical, disputed factual issues, without conducting a trial on those issues, as Section 4 of the FAA requires. The court improperly accepted the allegations in the Amended Complaint that Thomas acted "with the purpose of defrauding the District" as sufficient to conclude that his purchase of the insurance services was not in furtherance of the District's business, and that the District

derived no value from those services. JA383-384. The Court's conclusions are unsupported by record evidence. They should not stand.

This Court need not address the merits of the district court's decision, however, because the district court should not even have reached the issues it decided. Where, as here, an employer seeks to evade a contract based on its employee's acceptance of kickbacks, that sounds in "fraudulent inducement." As the district court acknowledged in its opinion, allegations of fraudulent inducement go to a contract's validity, not to its formation. And as the court's own FAA analysis recognized, questions concerning the validity of the contract as a whole must be decided by the arbitrator, not the court. For that reason, too, the court's decision denying arbitration of the District's claims should be reversed.

Standard of Review: This Court "review[s] de novo a district court's denial of a motion to compel arbitration." *Muriithi v. Shuttle Express, Inc.*, 712 F.3d 173, 178 (4th Cir. 2013). The Court also "review[s] de novo questions of state contract law" where relevant to a challenge to an arbitration agreement. *Id.* "Any uncertainty regarding the scope of arbitrable issues agreed to by the parties must be resolved in favor of arbitration." *Id.* at 179.

I. THE DISTRICT COURT MISCONSTRUED SOUTH CAROLINA AGENCY LAW IN HOLDING THAT THE DISTRICT WAS NOT BOUND BY ITS CHIEF FINANCIAL OFFICER'S PURCHASE OF INSURANCE SERVICES ON ITS BEHALF

A. "'Under fundamental principles of South Carolina law, a master is liable for and is charged with knowledge of the acts and conducts of his servants operating within the scope of their employment.'" *Murphy v. Jefferson Pilot Commc'ns Co.*, 613 S.E.2d 808, 812 (S.C. Ct. App. 2005); *see West v. Serv. Life & Health Ins. Co.*, 66 S.E.2d 816, 817 (S.C. 1951). That rule does not require that "the particular act creating liability was within the servant's authority." *Crittenden v. Thompson-Walker Co.*, 341 S.E.2d 385, 387 (S.C. Ct. App. 1986). Rather, "'[i]f the servant is doing ***some act*** in furtherance of the master's business, he will be regarded as acting within the scope of his employment, although he may exceed his authority.'" *Id.* (emphasis added).

Under that law, Thomas, acting as the District's CFO, bound the District to the Brokerage Services Agreements and the arbitration clauses they contain. The District's Amended Complaint (and the criminal Information on which it relies) expressly acknowledges that Thomas's official responsibilities as CFO encompassed his conduct here—obtaining insurance policies, selecting insurance brokers, and authorizing payment to vendors. JA135-136 ¶19; JA199 ¶5.

B. The district court likewise acknowledged that "[n]ormally, Thomas, as the Chief Financial Officer of the District, would have the authority to act on

behalf of the District, binding the District to the Brokerage Service Agreements"—and the arbitration clauses they contained. JA384. The court nevertheless held that the contracts Thomas entered and performed on the District's behalf were never actually formed because Thomas allegedly "used his position to defraud the District" by accepting kickbacks. JA384-385. While not calling it by name, the court invoked agency law's adverse interest exception, which "provides that where the action of the agent is clearly adverse to the principal, the agent's actions are not imputed to the principal." *In re Infinity Bus. Grp. Inc.*, 497 B.R. 794, 809 (Bankr. D.S.C. 2013); *see also Crystal Ice Co. of Columbia, Inc. v. First Colonial Corp.*, 257 S.E.2d 496, 498 (S.C. 1979); *Grayson Consulting, Inc. v. Wachovia Sec., LLC (In re Derivium Capital LLC)*, 716 F.3d 355, 367 (4th Cir. 2013). But the court misconstrued the scope of the adverse interest exception under South Carolina law. The adverse interest exception does not apply every time an agent does something illegal or otherwise damaging to his principal. South Carolina, like the majority of jurisdictions, "requires ***total abandonment*** of the principal's interest and ***no benefit*** to the principal in order to apply the adverse interest exception." *Infinity*, 497 B.R. at 812 (emphasis added).

To illustrate, in *Citizens' Bank v. Heyward*, a borrower agreed to pay 8 percent interest to a bank, and an additional 2 percent interest to the bank's president personally. 133 S.E. 709, 710 (S.C. 1925). The Supreme Court of South Carolina

held the bank liable for usury based on the combined 10 percent interest rate—even though the bank never "received any portion of the [president's 2 percent] commission" or "knew of, authorized, or ratified the unlawful act of its president." *Id.* at 710-11. The court "distinguish[ed] between the authority to commit a fraudulent act and the authority to transact the business in the course of which the fraudulent act was committed." *Id.* at 712-13. "The proper inquiry is, ***whether the act was done in the course of the agency and by virtue of the authority as agent***. If it was, then the principal is responsible"—even if the act was "fraudulent" and "although the principal did not authorize or justify or participate in, or indeed know of such misconduct, or even if he forbade the acts or disapproved of them." *Id.* at 713. Thus, "[e]ven though the agent's act of accepting the additional 2% commission was for his personal benefit and was adverse to the bank due to its unlawful nature, the Supreme Court [of South Carolina] stated that 'it is a mistake to suppose that the bank was not benefited by the fraudulent act of [the president], as it could not be carried into effect, except by securing a borrower for the bank, out of whom it made several thousand dollars.'" *Infinity*, 497 B.R. at 811 (alteration in original) (quoting *Heyward*, 133 S.E. at 714).

Consistent with *Heyward*, other South Carolina cases similarly hold that a principal is bound unless the agent completely abandons the principal's interest and acts solely for some individual purpose "***wholly disconnected*** with the further-

ance of his master's business." *Crittenden*, 341 S.E.2d at 387 (emphasis added); *see also, e.g.*, *Hancock v. Aiken Mills*, 185 S.E. 188, 190-91 (S.C. 1936) ("wholly disconnected with his employment"); *Hyde v. S. Grocery Stores*, 15 S.E.2d 353, 357 (S.C. 1941) (same); *Mauldin Furniture Galleries, Inc. v. Branch Banking & Tr. Co.*, C.A. No. 6:10-240-TMC, 2012 WL 3680426, at *7 (D.S.C. Aug. 27, 2012) ("act[s] solely for the agent's own purposes"). So as in most jurisdictions, "'if the agent acts for the benefit of the [principal] at least in part, the adverse interest exception does not apply.'" *Allard v. Arthur Anderson & Co. (USA)*, 924 F. Supp. 488, 495 (S.D.N.Y. 1996).[5]

The only case the district court discussed—*Young v. FDIC*, 103 F.3d 1180 (4th Cir. 1997)—is consistent with that rule. In *Young*, this Court held that a bank officer acted outside the scope of his employment when he falsely represented that another company from which the plaintiff had bought a surety bond had deposited money at the bank. *Id.* at 1189-90. The bank, however, was not relieved of liability for the officer's acts merely because he had committed a fraud. *Young* confirmed that "[u]nder South Carolina law, an act falls within the scope of

[5] *See also, e.g.*, *Kirschner v. KPMG LLP*, 938 N.E.2d 941, 952 (N.Y. 2010) ("'[The exception] cannot be invoked merely because [the agent] has a conflict of interest or because he is not acting primarily for his principal.'"); *James Cape & Sons Co. ex rel. Polsky v. Streu Constr. Co.*, 775 N.W.2d 277, 281 (Wis. 2009) ("[S]o long as the employee was not entirely motivated by his or her own purposes, but intended, at least in part, to serve his or her employer, the employee's conduct is imputed to the employer.").

employment even if the employee exceeded his or her authority and even if the employee acted contrary to the express orders of the employer." *Id.* at 1190. Rather, the bank was not liable because the officer had not "acted with the purpose of benefiting [his employer] ***even incidentally***." *Id.* (emphasis added).

C. The district court did not apply South Carolina's law governing the adverse interest exception. It did not conduct the "proper inquiry," which is "***whether the act was done in the course of the agency and by virtue of the authority as agent***." *Heyward*, 133 S.E. at 713. And while the court acknowledged that the adverse interest exception asks whether the agent's conduct was "***wholly disconnected*** from the furtherance of his employer's business," JA384-385 (emphasis added) (quoting *Vereen v. Liberty Life Ins. Co.*, 412 S.E.2d 425, 429 (S.C. Ct. App. 1991)), it never applied that standard to Thomas's conduct.

The district court applied a different standard. It held that the District was absolved of responsibility for Thomas's actions on the grounds that he acted "for the independent purpose of receiving kickbacks" and that his conduct "actually harmed the district." JA385. As explained below (at 35-44), those conclusions are factually unsupported. But they are not sufficient to apply the adverse interest exception under South Carolina law in any event. After all, the bank president in *Heyward* authorized a bank loan for the independent purpose of taking an unauthorized personal commission. 133 S.E. at 710. And his conduct actually

harmed the bank by rendering the loan usurious. *Id.* But those facts did not relieve the bank from liability for its president's fraudulent actions.

Because the district court applied the wrong legal standard, it reached the wrong result. Thomas may have had a motivation to "lin[e] his pocket." JA385. But that does not change the fact that his actions in purchasing insurance services for the District plainly were "done in the course of," *Heyward*, 133 S.E. at 713, and were not "wholly disconnected from," *Crittenden*, 341 S.E.2d at 387, his duties as the District's CFO. The Complaint itself acknowledges that it was Thomas's responsibility as CFO to "obtain[] insurance contracts and select[] who would broker those contracts." JA165 ¶171; *see* JA166 ¶172 (Thomas steered insurance policy and consulting purchases "[i]n his position as the District's Chief Financial Officer"). The district court's failure to apply the proper legal standard warrants reversal.

II. THE DISTRICT COURT ERRED IN RESOLVING CRITICAL FACTUAL ISSUES AGAINST THE INSURANCE DEFENDANTS WITHOUT A TRIAL AND WITHOUT EVIDENTIARY SUPPORT

The district court not only misapplied the governing law when it denied the Insurance Defendants' motion to compel arbitration. It also decided disputed factual issues against the Insurance Defendants, without providing them notice and without conducting the "trial" that the FAA requires in such situations. 9 U.S.C.

§4. The court also made sweeping conclusions on what it deemed the dispositive questions—without evidentiary support. Each of those errors warrants reversal.

A. The District Court Resolved Disputed Factual Issues Without Conducting the "Trial" the FAA Requires

1. "When it's apparent from a quick look at the case that no material disputes of fact exist it may be permissible and efficient for a district court to decide the arbitration question as a matter of law through motions practice . . . ." *Howard v. Ferrellgas Partners, L.P.*, 748 F.3d 975, 978 (10th Cir. 2014) (Gorsuch, J.). But when such a motion "presents unresolved questions of material fact, the FAA 'call[s] for an expeditious and summary hearing' to resolve those questions." *Dillon v. BMO Harris Bank, N.A.*, 787 F.3d 707, 713 (4th Cir. 2015) (alteration in original). Section 4 of the FAA provides that when "the making of the arbitration agreement . . . [is] in issue, the court shall proceed summarily to the trial thereof." 9 U.S.C. §4.

This Court has explained that, when the party resisting arbitration challenges "the existence of an agreement to arbitrate," the court should initially apply a standard "akin to . . . summary judgment." *Chorley Enters., Inc. v. Dickey's Barbecue Rests., Inc.*, 807 F.3d 553, 564 (4th Cir. 2015). The party opposing arbitration thus "may not rest upon the mere allegations or denials of her pleading but must instead, ***by affidavit or other evidentiary showing***, set out specific facts." *Roach v. Navient Sols., Inc.*, 165 F. Supp. 3d 343, 348 (D. Md. 2015); *see Tinder v.*

Pinkerton Sec., 305 F.3d 728, 735 (7th Cir. 2002) (similar). "If there is an issue of fact as to the making of the agreement for arbitration, then a trial is necessary." *Bensadoun v. Jobe-Riat*, 316 F.3d 171, 175 (2d Cir. 2003). The district court may not "deny the motion without holding 'any trial to resolve [a] dispute of fact.'" *Dillon*, 787 F.3d at 713.

2. Those procedures were not followed here. When the Insurance Defendants moved to compel arbitration, they had every reason to believe this was an appropriate case for the "court to decide the arbitration question as a matter of law through motions practice." *Howard*, 748 F.3d at 978. Their arguments for compelling arbitration were primarily legal. *See* JA66-82. They had no reason to believe that the District would deny that the Brokerage Service Agreements containing the arbitration clauses had been ***formed*** as a matter of South Carolina law. After all, the District's Complaint at the time alleged that it had "entered into multiple contracts with the Insurance Defendants for consulting services," JA62-63 ¶234; asserted claims under South Carolina law for breach of those contracts, *see id.* ¶¶233-36; and sought damages based on the precise amounts the District paid pursuant to those contracts, JA65. Based on those admissions, *see Bright v. QSP, Inc.*, 20 F.3d 1300, 1305 (4th Cir. 1994), there was no dispute as to formation of the contracts between the District and the Hub Defendants.

Faced with the motion to compel arbitration, the District did an about-face. It amended its Complaint to drop its breach-of-contract claims. *See* pp. 14-15, *supra*. And its brief in opposition to arbitration suddenly denied that the contracts ever were formed. The District, however, offered little evidentiary support for those arguments. Indeed, with respect to its one-page argument that it could not be bound by Thomas's actions, it offered no evidence whatsoever, resting entirely on its own "alleg[ations] in the Amended Complaint." Dkt. 33 at 26. But allegations are insufficient to raise an issue of material fact in support of the District's arguments. "[A] party cannot avoid compelled arbitration by generally denying the facts upon which the right to arbitration rests"—it "must identify specific evidence in the record." *Tinder*, 305 F.3d at 735. Thus, under the relevant standard—one "akin to . . . summary judgment," *Chorley*, 807 F.3d at 564—the District had failed to carry its burden.

The district court held oral argument on the motion to compel arbitration. *See* Dkt. 53. The court primarily focused on legal questions, such as whether the District's challenges to arbitration were issues for the court or the arbitrators to decide. *See, e.g.*, JA343 ll. 15-16. The court did not address the issue of Thomas's authority to bind the District at all—much less probe the factual basis for the District's arguments under the adverse interest exception.

When the district court issued its decision denying arbitration, however, it unexpectedly decided questions that hinged on critical factual issues. For example, it summarily decided:

- That the District "did not know these Brokerage Service Agreements containing the Arbitration Clauses even existed," JA382, despite the facts that the original Complaint asserted that the District had entered into contracts with the Insurance Defendants, JA62-63 ¶234; the original contract was voted on by the Berkeley County School Board, JA325; and the District paid over $1.9 million under the Brokerage Service Agreements over the years, JA24 ¶44; *see also* JA142 ¶48.

- That Thomas accepted and caused the District to pay fees under the 2002, 2003, 2006, 2009, and 2011 Brokerage Service Agreements "with the purpose of defrauding the District," JA383, even though there was ***no evidence*** of kickbacks before February ***2013***, *see* JA136-137 ¶22.

- That Thomas "was not acting in furtherance of the District's business because the payments to the Insurance Defendants actually harmed the District," JA385, even though the District had taken out similar insurance policies with other companies in the past, JA148 ¶79, and even though the District made claims on the policies it procured through the Insurance Defendants, JA159 ¶136.

- That Angel Cartwright's signature on the first Brokerage Service Agreement did not bind the District, notwithstanding that she was a District employee, because she was Thomas's "underling," JA381—although there was no evidence that her position had limited scope of authority or that she was complicit with Thomas in the alleged scheme.

The district court's decision to resolve such questions, which implicate disputed factual issues, without affording the Insurance Defendants an evidentiary hearing to address those issues, exceeded its authority under Section 4 of the FAA.

The court was not permitted to "deny the motion [to compel arbitration] without holding 'any trial to resolve [a] dispute of fact.'" *Dillon*, 787 F.3d at 713. The fact that the court denied the Insurance Defendants the process they were due under the FAA itself warrants reversal. *See, e.g.*, *Howard*, 748 F.3d at 978.

B. The District Court's Key Findings Are Unsupported by Evidence

The district court's failure to conduct an evidentiary trial to explore and resolve key issues of fact is ultimately reflected in its decision denying arbitration. A district court's conclusions "must find support in the evidence before it." *Vega v. T-Mobile USA, Inc.*, 564 F.3d 1256, 1267 (11th Cir. 2009); *see also Micro-Strategy, Inc. v. Lauricia*, 268 F.3d 244, 253 (4th Cir. 2001) (reversing district court's denial of arbitration where its key "factual conclusion" was "without evidentiary support"). But the findings that are the linchpins of the court's decision are unsupported by record evidence, and do not address the evidence to the contrary.

1. *The District Court's Finding That the District Did Not Know About the Contracts Cannot Be Sustained*

The district court absolved the District of any actual knowledge of, and thus responsibility for, the Brokerage Service Agreements containing the arbitration clauses. It did so based on the District's counsel's "represent[ation] to the court that it did not know" those contracts "even existed until HUB filed its motion to compel arbitration." JA382. It found that representation of counsel "supported"

by the fact that some of the agreements in the Hub Defendants' files "are unsigned." *Id.* The court concluded that "[t]he District obviously could not have agreed to the Brokerage Service Agreements if it did not know they existed." *Id.* But the slender reed on which the court based that conclusion was contradicted by substantial evidence—none of which the court addressed.

First, the notion that the District did not know that the contracts "even existed" until the Hub Defendants filed their arbitration motion is contradicted by the District's own original Complaint. As explained above, that Complaint—filed well before the arbitration motion—represented that the District had "entered into multiple contracts with the Insurance Defendants for consulting services," JA62-63 ¶234; asserted claims under South Carolina law for breach of those contracts, *id.* ¶¶233-236; and sought damages based on the precise amounts the District paid pursuant to those contracts, *see* JA63 ¶236; JA65. The District later regretted those representations and omitted them from the Amended Complaint. But representations in a superseded pleading are still "evidence as an admission of the party" that made them. 6 Charles A. Wright, et al., Federal Practice & Procedure §1476 (3d ed.); *see also Andrews v. Metro N. Commuter R.R. Co.*, 882 F.2d 705, 707 (2d Cir. 1989) ("'A party cannot advance one version of the facts in his pleadings, conclude that his interest would be better served by a different version,

and amend his pleadings to incorporate that version, safe in the belief that the trier of fact will never learn of the change in stories.'" (alterations omitted)).

There could hardly be stronger evidence that the District knew about the existence of the contracts than ***its own unequivocal assertion*** that it "***entered into multiple contracts with the Insurance Defendants for consulting services***." JA62-63 ¶234 (emphasis added). (And if the District actually had no reason to know that binding contracts existed, as it later represented, then its assertion of breach-of-contract claims was sanctionable misconduct under Rule 11. *See* Fed. R. Civ. P. 11(b) ("By presenting to the court a pleading . . . an attorney . . . certifies . . . [that] the factual contentions have evidentiary support . . . .").) Yet the district court did not consider the District's prior representations at all, and instead accepted its counsel's self-serving about-face at oral argument.

Second, there is no evidence that Thomas concealed the Brokerage Service Agreements, or the payments made in satisfaction of them, from the District. To the contrary, the evidence shows that Thomas entered into the agreements with the District's express knowledge and approval. Knauff was selected as the District's "Agent of Record in regard to all property/casualty insurance matters" as the "result of a board vote." JA325. The District's superintendent sent a letter in June 2001 recognizing Knauff's status. JA327. The notion that the District did not know about the contractual agreement defies the record.

Moreover, the District alleges that it paid over $1.9 million in "consulting and broker's fees" to Knauff from 2001 through 2012. JA24 ¶44 (about $1.6 million over the abridged 2005 to 2012 period in the Amended Complaint, JA142 ¶48). It is implausible that the District was not aware of these payments or the contracts that required them. Indeed, the Amended Complaint itself makes clear that District personnel other than Thomas were monitoring its insurance expenditures: It alleges that the District's Interim Director of Facilities once opined that the premium for Builder's Risk insurance on a construction project was too high, and that the project's design was tweaked to secure a lower premium. JA151 ¶¶92-94. Emails attached to the pleading also show other District employees' involvement in and awareness of insurance business with the Hub Defendants. *See* JA286-287 (Capital Projects Manager Connie Myers); JA306-308 (Risk Manager Rainy Talbert).

All of this evidence forecloses any argument that the District "did not know" that its agreements with the Hub Defendants "even existed." JA382. And the Hub Defendants brought all this to the district court's attention in their briefing. *See* Dkt. 38 at 8-10, 13. Yet the court summarily reached the opposite conclusion without addressing this evidence in its decision.

2. *No Record Evidence Supports the District Court's Conclusion That Thomas Was Engaged in a Kickback Scheme at the Time He Entered the Brokerage Service Agreements on the District's Behalf*

The district court held that the District was not bound by any of the Brokerage Service Agreements, and the arbitration clauses they contain, because Thomas entered those agreements "with the purpose of defrauding the District." JA383. As explained above (at 25-30), that is not the governing legal standard. But even on its own terms, the district court's conclusion fails because it is admittedly based on general "***allegations***" made in "the amended complaint." JA383 (emphasis added). Arbitration may not be denied based "upon the mere allegations" in the plaintiff's "pleading." *Roach*, 165 F. Supp. 3d at 348. Rather, an "***evidentiary showing***" is necessary. *Id.*; *see also Tinder*, 305 F.3d at 735. Yet the court cited no evidence to support the conclusion that Thomas was taking kickbacks, or engaged in any other fraudulent conduct, at the time he entered the Brokerage Service Agreements.

Upon further scrutiny, moreover, there is not even a credible ***allegation*** in the Amended Complaint that supports the district court's conclusion. The earliest check that the Amended Complaint cites as a kickback was dated ***2013***. JA136-137 ¶22. And the only other alleged kickbacks—in the form of hotel accommodations, dinner, or spa treatments—relate to one dinner in April ***2015*** and another meeting in August ***2016***. *See* JA 152 ¶100; JA162 ¶¶156-157. By

contrast, the Brokerage Service Agreements were entered into, and payments made pursuant to them, much earlier—in ***2002***, ***2003***, ***2006***, ***2009***, and ***2011***. *See* pp. 9-12, *supra*.[6] Thus, even if one accepts as truth the allegation that Thomas was engaged in a kickback scheme in 2013, that in no way establishes that Thomas was conducting his business as CFO "with the purpose of defrauding the District" throughout the decade preceding the payment of any kickbacks. JA383.[7]

In short, the entire premise of the district court's decision denying arbitration under the adverse interest exception is devoid of evidentiary support.

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[6] The Amended Complaint does allege that "Thomas and the Insurance Defendants engaged in" kickback schemes "to procure or maintain the District's insurance business" "since at least 2005." JA137 ¶25. But without further "factual context" to support it, such "conclusory statements" would not even survive a Rule 12(b)(6) motion to dismiss. *Ashcroft v. Iqbal*, 556 U.S. 662, 686 (2009); *see also Nemet Chevrolet, Ltd. v. Consumeraffairs.com, Inc.*, 591 F.3d 250, 255 (4th Cir. 2009) ("bare assertions devoid of further factual enhancement fail to constitute well-pled facts"). They certainly cannot support denying arbitration under Section 4 of the FAA.

[7] Any argument by the District that Thomas was engaged in ***other*** wrongdoing before 2013 obviously would not affect whether he was acting within the scope of his authority with respect to the specific actions of entering into the Brokerage Service Agreements with the Hub Defendants. Nor, in any event, is there any evidentiary basis for concluding that the Insurance Defendants knew about Thomas's other misconduct, such as that alleged in the federal criminal Information. The District thus would separately be bound by Thomas's actions based on his apparent authority as CFO. *See Rickborn v. Liberty Life Ins. Co.*, 468 S.E.2d 292, 296 (S.C. 1996) ("Those dealing with an agent, without notice of restrictions upon his authority, have a right to presume that his authority is coextensive with its apparent scope, and as broad as his title indicates.").

3. *There Is No Factual Basis for Concluding That the District Was Harmed by Thomas Procuring the Brokerage Service Agreements*

The district court further held that Thomas "was not acting in furtherance of the District's business" when he ordered payments pursuant to the Brokerage Service Agreements "because the payments to the Insurance Defendants actually harmed the District." JA385. But on that critical issue, the court offered nothing more than a conclusory statement. It did not even provide an ***explanation*** why it thought the District was harmed by making payments required by the Brokerage Service Agreements—much less support it with evidence as required. *See Micro-Strategy*, 268 F.3d at 253.

A cursory glance at the record, moreover, refutes the notion that Thomas's entry into the various insurance contracts harmed, and provided no benefit to, the District. For example, the District alleges that Thomas took bribes to "***steer***[] BCSD insurance policy purchase." JA135-136 ¶19 (emphasis added); *see* JA136 ¶21, JA138-139 ¶31, JA151 ¶91 (similar). At most, that suggests the District may have been deprived of Thomas's "honest services" in choosing Knauff and Hub, ***rather than another broker***, to provide insurance services. *See* JA130; JA135-136 ¶19. Indeed, the Amended Complaint acknowledges that the District had previously purchased at least some of the same insurance from an unrelated broker, the Young Group, which the District has not accused of any wrongdoing. *See*

JA151-153 ¶¶95-103. Plainly, the insurance was deemed beneficial to the District before the alleged scheme, and there is no basis to conclude that it ceased to be beneficial to the District later.

Further, while the nature of insurance makes its benefits hard to quantify—health insurance is not without value simply because one enjoyed good health during a given policy period—the District admits it received payment for claims it made under some policies brokered by the Insurance Defendants. *See* JA159 ¶¶136-137.[8] That, too, undermines any finding that the insurance purchases only harmed, and did not benefit, the District.

4. *The District Court Had No Factual Basis To Conclude That Cartwright Could Not Bind the District*

Finally, it is undisputed that District employee Angel Cartwright signed the 2002 Brokerage Service Agreement—as did a Knauff representative. *See* JA92; JA381. The "general rule," of course, "is that where both parties have signed a contract, . . . the writing then represents or evidences the bargain between them." *Jaffe v. Gibbons*, 351 S.E.2d 343, 345 (S.C. Ct. App. 1986). The district court nevertheless refused to find the District bound by that signature.

[8] *See In re Merrill*, 252 B.R. 497, 508 (B.A.P. 10th Cir. 2000) (argument that a court "could look with hindsight on insurance premiums and take into account that they were not needed was unsound as the point of the insurance was to protect against risk").

The only reason the district court gave for disregarding that signed agreement was that "the District explained [Cartwright] was three or four levels below Thomas—an 'underling.'" JA381. For that vague description of her position, the court cited only an assertion by counsel at oral argument. *See id.* (citing JA351 ll. 3-7). Solely on that basis, the court "impute[d] [her] signature to Thomas," rather than the District. *Id.* at 28 n.10.

That does not withstand scrutiny. The court cited no facts indicating that Cartwright did not have actual or apparent authority to sign on the District's behalf. It cited no facts establishing that Cartwright signed the agreement solely at Thomas's direction, or that she was complicit in his alleged kickback scheme. And the court cited no law holding that the actions of an "underling" should be imputed to that employee's superiors in their individual capacity, rather than to the employer company, in any event. Indeed, when the District raised the argument at the hearing, the court rebuffed the very suggestion. In response to the District's "underling" comment, the court stated: "Her signature still binds them. Within the course and scope of her employment." JA351 ll. 6-7. The court offered no basis for reversing course in its final decision.

The district court thus disregarded an agreement executed by both parties on the basis of a single sentence uttered by counsel at oral argument, unsupported by evidence or legal authority. That too was reversible error.[9]

III. THE DISTRICT'S ARGUMENT IS A "FRAUDULENT INDUCEMENT" CLAIM THAT SHOULD HAVE BEEN RESERVED FOR THE ARBITRATORS

The district court thus erred, on multiple fronts, in holding that the District was not bound to the Brokerage Service Agreements based on its CFO's alleged participation in a kickback scheme. This Court need not address those substantive issues, however, because the district court erred in the first instance by not submitting them to the arbitrators for decision. While framed as a matter of contract formation and agency law, the district court's ruling actually sounds in fraudulent inducement. Under the Supreme Court's decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), claims of "fraud in the inducement of the contract generally" (as opposed to just the arbitration clause) must be decided by the arbitrators, not the court. *Id.* at 403-04.

In contract law, there is a distinction between "fraud in the inducement" and "fraud in the execution" (also called "fraud in the factum"). *Sw. Adm'rs, Inc. v. Rozay's Transfer*, 791 F.2d 769, 774 (9th Cir. 1986). "The former induces a party

[9] Even if Cartwright's signature could properly be "imputed" to Thomas, the district court had no basis to conclude that Thomas lacked the authority to enter into the relevant arbitration agreement in 2002. *See* pp. 39-42, *supra*.

to assent to something he otherwise would not have; the latter induces a party to believe the nature of his act is something entirely different than it actually is." *Id.*; *see also* 26 Williston on Contracts § 69:4 (4th ed.). Where a party can prove fraud in the execution, the contract is "void." 26 Williston, *supra*, § 69:4. But where the contract is found to have been fraudulently induced, the contract is deemed "operative"—that is, it was formed—but is "voidable" by the defrauded party. *Id.*; *see also Langley v. FDIC*, 484 U.S. 86, 94 (1987) ("fraud in the inducement . . . renders the note voidable but not void").

As courts have explained, where a party to a contract challenges the contract on the grounds that it was procured through a secret kickback scheme, that sounds in fraudulent inducement. In *In re 604 Columbus Avenue Realty Trust*, 968 F.2d 1332 (1st Cir. 1992), for example, a trust sought to recover from a bank $26,300 it had paid pursuant to a secret kickback agreement between a partner in the trust and an officer of the bank in exchange for the officer's assistance in securing the approval of a $1.5 million loan. *See id.* at 1338-40. The bank was in receivership with the FDIC at the time of the lawsuit, however, and the law granted the FDIC particular defenses to such claims under the so-called "*D'Oench* doctrine." *See id.* at 1343-45. Whether the *D'Oench* defense applied turned on whether the trust's claims for damages under the kickback scheme were properly characterized as claims for "fraud in the factum" or for "fraud in the inducement" of the tainted

loan agreement. *See id.* at 1346-47. The court held that the trust's claim based on the kickback scheme "was one of fraud in the inducement." *Id.* at 1347. The fraud did not go to the formation of the contract itself, because it did not concern "the basic nature of the obligation" the trust "assumed by entering" the loan contract. *Id.* Instead, the fraud concerned the "extraction" of money necessary to induce the bank to approve and enter the loan contract. *Id.*

An allegation of a kickback scheme is thus an allegation of fraudulent inducement: An improper gratuity is alleged to have been offered to "induce a person to assent to do something which he or she would not otherwise have done." 26 Williston, *supra*, § 69:4. Time and again, in a variety of contexts, courts have described kickback schemes as implicating questions of fraudulent inducement. *See, e.g.*, *United States v. Fagan*, 821 F.2d 1002, 1009-10 (5th Cir. 1987) (finding company was "fraudulently induced to part with its rental payments" by kickback scheme in mail fraud case); *United States v. George*, 477 F.2d 508, 513 (7th Cir. 1973) (similar); *Rozone Prods., LLC v. Raczkowski*, No. CIV. 09-5015-JLV, 2010 WL 3910170, at *5 (D.S.D. Sept. 29, 2010) (finding that allegations of kickback scheme support claim of "[f]raud in the inducement of a contract"); *cf. United States v. Acme Process Equip. Co.*, 385 U.S. 138, 147-48 (1966) (holding that the United States has the "right to cancel" contract procured by kickbacks).

The same is true here. The district court did not find any falsity or misrepresentation with regard to the terms of the Brokerage Services Agreements themselves. Instead, the crux of the district court's decision concerns ***why*** the District performed under the Brokerage Services Agreements—in the court's view, because Thomas "did so as part of a scheme" to receive kickbacks. JA383. However packaged, that is at bottom a fraudulent-inducement theory.

As a result, the issue the district court decided should have been reserved for the arbitrators. The Supreme Court has held that where, as here, a party seeks to avoid arbitration by asserting "fraud in the inducement of the contract generally," that issue must be decided by the arbitrators, not the court. *Prima Paint*, 388 U.S. at 403-04; *see also, e.g.*, *Hayes v. Delbert Servs. Corp.*, 811 F.3d 666, 671-72 (4th Cir. 2016); *Sydnor v. Conseco Fin. Serv. Corp.*, 252 F.3d 302, 307 (4th Cir. 2001) ("Claims of fraud applicable to the entire contract are generally resolved by an arbitrator."). Indeed, the district court itself recognized that principle. After a lengthy analysis of arbitration law, it held that it had authority to decide challenges to the "formation" of the Brokerage Services Agreements themselves, but not challenges to their "validity." JA372. For that reason, it declined to address the District's separate argument that the agreements were "induced by fraud," explaining that it concerned "the validity of" the contract, "not its formation." *See* JA380 n.9.

The district court thus erred in reaching the issue at all. The Supreme Court's command that questions of fraudulent inducement be reserved for the arbitrators is meaningless if the court can decide what is in substance the same question—based on the same set of facts—merely by repackaging it as an issue of agency law. The district court's decision of the issue here defeats the FAA's "emphatic federal policy in favor of arbitral dispute resolution." *Mitsubishi Motors*, 473 U.S. at 631. It should not stand.

CONCLUSION

The district court's order denying the motions to compel arbitration and stay litigation should be vacated. This Court should direct the district court to submit the case to arbitration or, alternatively, to conduct a trial of disputed issues under 9 U.S.C. § 4.

STATEMENT REGARDING ORAL ARGUMENT

Appellants respectfully request oral argument. This is an important case, and the issues would benefit from argument.

March 26, 2019

Respectfully submitted,

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