Contracts Tea no. 12 (March and April 2012)

SOUTH CAROLINA

In March 2012, the SC Court of Appeals has decided two arbitration cases concerning employment agreement that deserve attention: in the first (*Flexon v. PHC-Jasper)* the Court held that the dispute did not implicate interstate commerce and therefore the Federal Arbitration Act (FAA) did not apply, while in the second (*Lucey v. Meyer*), FAA applied because the contract did involve interstate commerce.[1]

In *Flexon* the FAA does not apply and since the arbitration clause is not compliant with South Carolina Arbitration Act, the arbitration is not compellable.

On March 7, 2012, *in Flexon v. PHC-Jasper*, No. 4950, the Court of Appeals affirmed the trial court's order denying a motion to compel arbitration.[2] Alleging a breach of contract by PHC-Jasper (dba as "Coast Carolina") Flexon sued in state court. Coastal Carolina filed a motion to compel arbitration. The parties stipulated that the arbitration provision in the Agreement failed to comply with the South Carolina Arbitration Act but Coastal argued the FAA applied. The trial court found that it did not and therefore, given the noncompliance with the South Carolina Arbitration Act, the arbitration could not be compelled. Coastal appealed. The Court

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[1] The FAA provides: "A written provision in any . . . contract evidencing a transaction *involving commerce* to settle by arbitration a controversy thereafter arising out of such contract . . . 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 (2010) (emphasis added). In *Allied-Bruce Terminix Cos. v. Dobson,* 513 U.S. 265 (1995), the US Supreme Court held that the phrase 'involving commerce' is the same as 'affecting commerce

[2] The arbitration clause in the agreement read like this:

> Except as to…., any controversy or claim arising out of or related to this Agreement, or any breach thereof, shall be settled by arbitration in the County, in accordance with the rules and procedures of alternative dispute resolution and arbitration . . . , and judgment upon any award rendered may be entered in any court having jurisdiction thereof.

of Appeals affirmed because it found that the FAA did not apply. Indeed, the surrounding facts "did not implicate interstate commerce.[3]"

In *Lucey* the FAA applies. In addition, the arbitration clause is not unconscionable and therefore the arbitration is compellable

On March 28, 2012 in *Lucey v. Meyer*, No. 4960, the Court of Appeals reversed the trial court's denial of the appellant's (employer, a law firm) motion to compel arbitration. The case concerns a dispute over an employment contract with a mandatory arbitration clause. The Court of Appeals held that the employment contract involved interstate commerce for the purposes of the FAA and therefore the FAA should be applied.[4] In addition – and this is the part of the decision that we are more interested in reporting – the Court of Appeals held that the arbitration clause should be enforced because it was not unconscionable: there was no absence of meaningful choice and the terms were not oppressive.
The arbitration clause in the agreement was the following:

> Any disputes arising in any way related to the matters set forth herein will be submitted to confidential, binding arbitration under expedited and abbreviated procedures, with the parties being the only witnesses called in person. If we are unable to agree on an arbitrator, I will choose one, you will choose one, and the two will choose a third.

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[3] "Flexon was a South Carolina resident, and Coastal hired him to provide medical services at the medical practice office located at 1010 Medical Center Drive, Hardeeville, South Carolina . . . and such other practice sites in Beaufort and Jasper counties as may be reasonably designated by [PHC] from time to time"

[4] This is the reasoning of the Court, based on Towles v. United Healthcare Corp., 524 S.E.2d 839 (Ct. App. 1999):

> We note Firm is a law firm based solely in South Carolina, and Meyer is only admitted to practice law in the state of South Carolina. While Firm is not a national employer as *United* was, Firm handles business with many out-of-state clients, similar to *United*. We think it is important factually that this is not a situation where Meyer simply worked in South Carolina on cases that involved out-of-state clients and businesses. Meyer travelled extensively to conduct legal work and billed hours for her out-of-state work and travel.

The Court cited to *Simpson v. MSA of Myrtle Beach*, Inc., 644 S.E.2d 663, 668 (2007) holding that "a party may seek revocation of the contract under 'such grounds as exist at law or in equity,' including fraud, duress, and unconscionability." *Simpson* is also cited for the proposition that "general contract principles of state law apply in a court's evaluation of the enforceability of an arbitration clause." *Simpson*, 644 S.E.2d at 668, and that "in South Carolina, unconscionability is defined as the absence of meaningful choice on the part of one party due to one-sided contract provisions, together with terms that are so oppressive that no reasonable person would make them and no fair and honest person would accept them." Id. at 668. With particular reference to arbitration clauses, to determine whether the above requirements are met, the SC Supreme Court adopted the standard established by the Fourth Circuit in *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933, 938 (4th Cir. 1999), i.e. courts should "focus generally on whether the arbitration clause is geared towards achieving an unbiased decision by a neutral decision-maker." Id. at 668.

As for the absence of meaningful choice, the Court of Appeals argues that even if the agreement with the arbitration clause offered to Ms. Meyer was an adhesion contract, this does not mean per se "absence of meaningful choice". Ms Meyer was a sophisticated party with a law school degree; she was given time to pounder over the agreement, and the facts show that Meyer had some bargaining power; indeed, in another case she had bargained for the exclusion of a clause that she did not want. There was no element of surprise because the agreement was only three pages and the arbitration clause was not 'buried' among many pages. The Court rejected Meyer's argument that the absence of meaningful choice was given by a "negative economic climate" because Meyer nevertheless maintained the "meaningful choice of whether to sign the contract or not [and in addition] …. the Firm did not contribute to the negative economic climate."

As for the oppressiveness, the Court found that the arbitration clause was "not one-sided, nor … oppressive to Meyer." The Court of Appeals cited again to the Fourth Circuit. *In re Cotton Yarn Antitrust Litig.*, 505 F.3d 274, 286 (4th Cir. 2007) the Fourth Circuit held that "while discovery generally is more limited in arbitration than in litigation, that fact is simply one aspect of the trade-off between the 'procedures and opportunity for review of the courtroom [and] the simplicity, informality, and expedition of arbitration' that is inherent in every agreement to arbitrate." Here, "while the arbitration clause … does limit discovery

by allowing the parties to be the only witnesses called in person, this cannot, standing alone, be a reason to invalidate an arbitration agreement. The Court considered that "the arbitration restriction applies equally to both parties, and the clause places no apparent restrictions on the introduction of depositions of witnesses into arbitration proceedings" and therefore it was not oppressive and one-sided.

Since there was no absence of meaningful choice nor oppressiveness, the Court of Appeals reversed the trial court's decision and enforced the arbitration clause.

NEW YORK

The owners of a property are almost always third party beneficiary of the services rendered by the subcontractors on the property.

The plaintiffs are the owners of an historic residence. They contracted with L.S.M. General Contractors, Inc. (LSM) to be the general contractor for a rehabilitation project on that residence. LSM subcontracted with Henry Isaacs Home Remodeling and Repair and Henry Isaacs ("Isaacs"), to perform the roofing work on the project. The Isaacs subcontracted with Hal Brewster to perform the roofing work. Hal Brewster badly performed the work on the roof, causing extensive leaking inside the house. LSM and the Isaacs initially attempted to correct the problems, but they subsequently abandoned the project. The owners sued everybody.

The parties presented several motions. In particular, the Isaacs raised a privity issue: they moved for summary judgment, contending that there was no privity between them and plaintiffs with respect to the breach of contract cause of action. The trial court granted the motion. The owners appealed.

The Appellate Division, Fourth Judicial Dept. held that "contrary to the contention of the Isaacs defendants, privity is not always required." While "as a general rule privity ... remains a predicate for imposing liability for nonperformance of contractual obligations . . . [an] obligation rooted in contract may [nevertheless] engender a duty owed to those not in privity when the contracting party knows that the subject matter of a contract is intended for the benefit of others . . . An intention to benefit a third party must be gleaned from the contract as a whole." (citing to *Van Vleet v Rhulen Agency*, 180 AD2d 846, 848-849 and *Drake v Drake*, 89 AD2d 207, 20I).

The party asserting a third-party beneficiary right must prove: (1) the existence of a valid and binding contract between other parties, (2) the contract was intended for [his or her] benefit and (3) the benefit to [him or her] is sufficiently immediate, rather than incidental, to indicate the assumption by the contracting parties of a duty to compensate [him or her] if the benefit is lost."[5] The focus is on the intent of the promisee, i.e. in the promisee's intent to give the beneficiary the benefit of the promised performance.

With particular reference to construction works, the analysis is quite straightforward. The Fourth Dept. held that "[i]t is almost inconceivable that those . . . who render their services in connection with a major construction project would not contemplate that the performance of their contractual obligations would ultimately benefit the owner . . ." (citing to *City of New York [Dept. of Parks & Recreation-Wollman Rink Restoration] v Kalisch-Jarcho, Inc.*, 161 AD2d 252, 253) and that courts "have generally refused to dismiss breach of contract causes of action asserted by property owners against subcontractors who performed construction services on their property". The Isaacs are exactly in this situation: it is almost "inconceivable" that they "did not know that plaintiffs, the owners of the home, would be the ultimate beneficiaries of the services being provided by the Isaacs."

There are exceptions of course, example when the subcontractor only supplies materials that can be used at any property. The Isaacs's case does not appear to fall into any exception but anyway whether an exception applies is normally a question of fact. Therefore the granting of the Isaacs's motion for summary judgment was wrong.

For further information, please contact info@nathancrystal.com.

[5] Citing to *Mendel v Henry Phipps Plaza W., Inc.*, 6 NY3d 783, 786, quoting *Burns Jackson Miller Summit & Spitzer v Lindner*, 59 NY2d 314, 336; *see DeLine v CitiCapital Commercial Corp.*, 24 AD3d 1309, 1311.