Contracts Tea no. 17 (April-August 2013)

NATIONAL

Courts cannot invalidate a contractual waiver of class arbitration simply because individual arbitration cost would exceed the recovery.

On June 20, 2013, the US Supreme Court (Justice Scalia's opinion) decided 5-3 in *American Express Co. v. Italian Colors Restaurant, 570 U. S. _____ (2013)* that the Federal Arbitration Act (FAA) does not permit courts to invalidate a contractual waiver of class arbitration on the ground that the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery.

The Second Circuit had refused to enforce the waiver and the arbitration provision inserted in American Express's card acceptance agreement against merchants accusing the credit card issuer of illegal tying. The Supreme Court reversed, holding that the FAA does not permit the judiciary to invalidate a waiver of this sort. The Supreme Court's reasoning goes this way: the FAA contains an "*overarching principle*" that "*arbitration is a matter of contract*" and the Congress did not make any exception for class-arbitration waiver. Nor we can say that the "*effective vindication*" exception – a dictum in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 – should invalidate the arbitration agreement at hand because, as made clear in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), while the "effective vindication" exception "*comes from a desire to prevent prospective waiver of a party's right to pursue statutory remedies … the fact that it is not worth the expense involved in* proving *a statutory remedy does not constitute the elimination of the* right to pursue *that remedy.*" In *AT&T Mobility LLC v. Concepcion*, 563 U.S. ____, the Supreme Court already clarified that "*class arbitration … [is not] necessary to prosecute claims that might otherwise slip through the legal system*".

Full opinion at http://www.supremecourt.gov/opinions/12pdf/12-133_19m1.pdf

This case continues a long line of cases in which the Supreme Court has upheld substantive and procedural limitations in arbitration agreements.

SOUTH CAROLINA

Contractual limitation on a home inspector's liability is not in contrast with public policy and not unconscionable.

On March 27, 2013 the SC Supreme Court (Justice Beatty and Justice Hearn dissenting) affirmed the summary judgment for Palmetto Home Inspection Services, LLC ("Palmetto"), holding that contractual limitation of a home inspector's liability does not

violate South Carolina public policy (as expressed by the General Assembly) and, as a matter of law, is not so oppressive that no reasonable person would make it and no fair and honest person would accept it. *Gladden v. Palmetto Home Inspection Services*, No. 27236.[1]

These are the facts: while purchasing their home, the Gladdens hired Palmetto for a home inspection. The contract contained a limit of liability clause, which limited Palmetto's liability to the home inspection fee. In particular, the clause provided the following:

> **LIMIT OF LIABILITY:**[]It is understood and agreed that should [Palmetto] and/or its agents or employees be found liable for any loss or damages resulting from a failure to perform any of it's [sic] obligations, including but not limited to negligence,[]breach of contract or otherwise, the the [sic] liability of [Palmetto] and/or it's [sic] agents or employees *shall be limited to a sum equal to the amount of the fee paid by the client* for this inspection and report. [emphasis added]

When the Gladdens sued the seller, real estate agents, and real estate companies because of defects in the house, they also sued Palmetto, for "*breach of contract for failing to conduct the inspection in a thorough and workmanlike manner and to report defective conditions in the home*." Both the Gladdens and Palmetto moved for summary judgment on the legal issue of the enforceability of the limit of liability clause (obviously the Gladdens to find it unenforceable and Palmetto to find it enforceable). The circuit court granted Palmetto's motion, so enforcing the clause (Palmetto had already refunded the service fee to the Gladdens). The Gladdens appealed. The SC Supreme Court confirmed the lower court's pronouncement. This is the Court's reasoning: (1) courts "*must determine public policy by reference to legislative enactments wherever possible*"; (2) the General Assembly "*has spoken on the issue of home inspections and liability for undisclosed defects*" by imposing "*licensure requirements*" (*See* S.C. Code Ann. §§ 40-59-500 et seq. (2011); (3) the General Assembly did not require "*home inspectors to carry errors and omissions liability insurance*" (unlike other states, for example New Jersey); (4) the General Assembly gave protection to purchasers for undisclosed defects in the Residential Property Condition Disclosure Act which requires buyers are "*informed of defects of which the seller has knowledge*" (*See* S.C. Code Ann. §§ 27-50-10 et seq. (2007 & Supp. 2011) and imposes "*liability on a seller if she knowingly withholds such information. § 27-50-65*"; (5) by so providing, "*the General Assembly has already provided specific protection for the consumer risks associated with undisclosed defects*". The Court said that they "*must defer to … [the General Assembly's] judgment.*" However, the Court did not only defer to that judgment, it also approved it: it would be unfair, according to the Court, to impose liability on a party

[1] Full opinion at http://www.judicial.state.sc.us/opinions/HTMLFiles/SC/27236.pdf

which is unaware of defects and only performs a limited review: "the *General Assembly has imposed liability on the party with greatest access to information about the home's defects, where it most logically resides.*"

As for the unconscionability claim, the Court said that "*limitation of liability and exculpation clauses are routinely entered into … [and] they are commercially reasonable in at least some cases, since they permit the provider to offer the service at a lower price.*" Therefore the Court excluded that "*a limitation of liability clause in a home inspection contract is so oppressive that no reasonable person would make it and no fair and honest person would accept it.*"

The dissent made the point that the contract was an adhesion contract and that the parties did not have equal bargaining power. In addition, the limitation of liability was not conspicuous. The dissent also noted as other courts in the country have held that a limitation of liability clause in a home inspection contract is unconscionable (*Pitts v. Watkins*, 905 So. 2d 553 (Miss. 2005); *Lucier v. Williams*, 841 A.2d 907 (N.J. Super. Ct. App. Div. 2004)). In particular, the NJ did not

> hesitate to hold it unenforceable for the following reasons: (1) the contract, prepared by the home inspector, is one of adhesion; (2) the parties, one a consumer and the other a professional expert, have grossly unequal bargaining status; and (3) the substance of the provision eviscerates the contract and its fundamental purpose because the potential damage level is so nominal that it has the practical effect of avoiding almost all responsibility for the professional's negligence.

We agree with the dissent's reasoning for the reasons listed by the NJ court.

In addition, by allowing home inspection companies to limit responsibility for undisclosed defects to the paid price, the only incentive that a company has to do a diligent job in the inspection, seems to be its reputation. Is that enough?

It is interesting to contrast this case with some recent South Carolina appellate decisions invalidating arbitration clauses on unconscionability grounds.

A subsequent creditor may set aside a voluntary transfer if it was made with actual fraudulent intent to evade creditors.

In *Judy v. Judy*, N. 5101, the SC Court of Appeals held that a subsequent creditor may set aside a voluntary transfer if it was made with actual fraudulent intent on the part of the grantor to evade creditors. Full opinion at http://sccourts.org/opinions/HTMLFiles/COA/5101.pdf

Ronnie F. Judy ("Ronnie") owned land and farming equipment. In 1998 and in 2007, because of threatened liabilities, Ronnie conveyed his interest in the land and equipment to

his children, Todd and Ryan towards $5.00, love, and affection but he continued to farm the land, receive revenue from it, and borrow money against it. In 2007, because of alleged damages to the property, Jimmy, Bobby, and Kevin Judy, brothers Ronnie, sued Ronnie, Todd, and Ryan seeking to void the several conveyances. The special referee found both the conveyances violated Section 27-23-10(A) of the South Carolina Code (2007), so called "Statute of Elizabeth." [2] The defendants appealed and contended that the plaintiffs lacked standing to assert the Statute of Elizabeth because the plaintiffs were not subsequent creditors at the time of the transfers of property. The Court of Appeals, citing South Carolina precedents, disagreed, stating that *"[t]he Statute of Elizabeth does not limit its application to judgment creditors. Its protection also extends to other types of parties defrauded in connection with the conveyance of property."*

In so holding, the court reminded the necessary requirements for the Statute of Elizabeth to apply: [3] there must be a (1) voluntary transfer (that is, a transfer without consideration) (2) made with a view to future indebtedness or with actual fraudulent intent on the part of the grantor to evade creditors. We are talking about a showing of 'actual moral fraud,' rather than legal fraud",[4] i.e. a *"a conscious intent to defeat, delay, or hinder [one's] creditors in the collection of their debts."*[5] The Court also reminded that the SC precedents are in the sense that "*with a voluntary inter-family transfer, the burden shifts to the transferee to establish the transfer was valid."*[6]

In conclusion, the Court of Appeals affirmed the special referee's decision because it found clear and convincing evidence that the conveyances were title-only transfers intended to confound or hinder creditors. However, the court reversed the award of attorney's fees against the appellant, finding the award constituted an abuse of discretion.

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[2] Section 27-23-10(A) of the South Carolina Code (2007):

> Every gift, grant, alienation, bargain, transfer, and conveyance of lands, tenements, or hereditaments, goods and chattels or any of them, or of any lease, rent, commons, or other profit or charge out of the same, by writing or otherwise, and every bond, suit, judgment, and execution which may be had or made to or for any intent or purpose to delay, hinder, or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, and forfeitures must be deemed and taken (only as against that person or persons, his or their heirs, successors, executors, administrators and assigns, and every one of them whose actions, suits, debts, accounts, damages, penalties, and forfeitures by guileful, covinous, or fraudulent devices and practices are, must, or might be in any ways disturbed, hindered, delayed, or defrauded) to be clearly and utterly void, frustrate and of no effect, any pretense, color, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding.

[3] Mathis v Burton, 319 S.C. at 265, 460 S.E.2d (1995) (citing Gentry v. Lanneau, 54 S.C. 514, 32 S.E. 523 (1899))

[4] *Mathis.*

[5] First Carolinas Joint Stock Land Bank of Columbia v. Knotts, 191 S.C. 384, 409, 1 S.E.2d 797, 808 (1939).

[6] Windsor Props., Inc. v. Dolphin Head Constr. Co., 331 S.C. 466, 471, 498 S.E.2d 858, 860 (1998).

NEW YORK

Fair market value as measure of damages in real estate breach of contracts.

On March 21, 2013, the NY Court of Appeals decided *White v. Farrell* and adopted for the first time, the fair market value rule for damages.

Plaintiff brought an action for breach of contract, fraudulent inducement and negligent misrepresentation against the sellers of her newly constructed home to recover the down payment. Plaintiff alleged that she and her husband cancelled the contract because the defendants misrepresented in their Property Disclosure Statement that there were no flooding or drainage problems, and then failed to correct the problems. The sellers counterclaimed for breach of contract and to recover the difference between the contract price and the price for which the house was sold 1 year after, plus consequential damages. Both sides moved for summary judgment. The Supreme Court granted sellers' motion, holding that the plaintiff breached the contract but did not grant any damage: indeed, the damage are measured by "*the difference between the contract price and the "fair market value" of the real property at the time of the breach*" but here the two were the same. It also concluded that the claim for consequential damages was not valid. The Appellate Division affirmed. So did also the Court of Appeals but only in part because it remitted several issues to the Supreme Court. However, the importance of the decision lies on the fact that the Court of Appeals for the first time adopts the "fair market" rule for the measure of damages in a breach of contract of sale of real property:

> We hold that the measure of damages is the difference, if any, between the contract price and the fair market value of the property at the time of the breach. The price obtained by the seller on a later resale of the property may well bear on damages, depending upon the circumstances.[7]

Full opinion available at
http://www.nycourts.gov/ctapps/Decisions/2013/Mar13/43opn13-Decision.pdf

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

[7] "*As matters stand in this case, there is conflicting evidence as to the property's fair market value when the buyer defaulted, an issue of fact, which precludes summary judgment.*"