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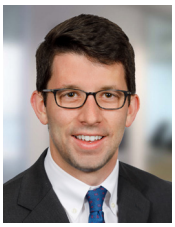
A REPORT TO MEMBERS OF THE SOUTH CAROLINA BAR YOUNG LAWYERS DIVISION

Damico & Public Policy: Mandatory Arbitration Clause Found Unenforceable and Court Declines to Sever



By J. Patrick Bradley

The South Carolina Supreme Court recently assessed the enforceability of an arbitration provision in contracts for the construction and sale of homes, and much of the Court's analysis appears to hinge on consumer-protection considerations. *See Damico v. Lennar Carolinas, LLC*, Op. No. 28114 (S.C. Sup. Ct. filed Sept. 14, 2022) (Howard Adv. Sh. No. 33 at 87). This article briefly outlines only some of the key subjects addressed by the Court in *Damico* but highlights the significance the Court has placed on public policy considerations and the possible impact on future drafting and enforcement of arbitration provisions to observe this *Damico* standard.

Damico Background

Briefly, *Damico* is a construction defect lawsuit brought by certain homeowners ("Petitioners") against their homebuilder and general contractor, Lennar Carolinas, LLC ("Lennar"). The dispute involves alleged defects at homes within The Abbey subdivision, a section of the Spring Grove Plantation neighborhood in Berkeley County, which all but one Petitioner purchased directly from Lennar via a purchase and sale agreement (hereinafter "sale agreement"). After the circuit court denied Lennar's motion to compel arbitration, finding the arbitration agreement between Lennar and Petitioners included the arbitration section of the parties' sales agreements as well as other documents (like the home warranty) and that the terms of the arbitration agreement were unenforceable, Lennar appealed.

On appeal, the South Carolina Court of Appeals reversed the circuit court, finding that it had violated the *Prima Paint* doctrine because the circuit court's order relied on terms outside of the arbitration provision in the sales agreements. *See Damico v. Lennar Carolinas, LLC*, 430 S.C. 188, 197, 844 S.E.2d 66, 71 (Ct. App. 2020) (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403–04 (1967)). The Court of Appeals ended its analysis by, among other things, quoting the following portion of the arbitration provision at issue: "All decisions respecting the arbitrability of any Dispute shall be decided by the arbitrator(s)," and then reasoned that "the parties clearly and unmistakably delegated to the arbitrator" the question of "[w]hether the disputes alleged in this lawsuit are covered by" the arbitration clause in the purchase contracts. *Id.* at 199, 844 S.E.2d at 73 (citing *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 109 U.S. 524, 530 (2019) ("Just as a court may not decide a merits question that the parties have delegated to an arbitrator, a court may not decide an arbitrability question that the parties have delegated to an arbitrator.")).

However, the South Carolina Supreme Court held that while the Court of Appeals properly limited the scope of the parties' arbitration agreement to the arbitration provision section in the sales agreements (hereinafter "Section 16" or "arbitration provision"), the Court of Appeals' erred in finding that the arbitrability assessment was for the arbitrator and not the court. *See Damico v. Lennar Carolinas, LLC*, Op. No. 28114 (S.C. Sup. Ct. filed Sept. 14, 2022) (Howard Adv. Sh. No. 33 at 97–98). The Supreme Court then analyzed the arbitration provision in the sales agreements,

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ultimately finding several sections unconscionable but declining to sever the unconscionable portions in the arbitration provision "for public policy reasons" given its finding that "this is a contract of adhesion" and "the transaction involves new home construction." *Damico* at 110. In doing so, the Court articulated a significant public policy concern that accompanied its contractual analysis.

Arbitration Provision is Unconscionable

First, the Court found the sales agreements were contracts of adhesion. While "not necessarily unconscionable," a contract of adhesion "may indicate one party lacked meaningful choice." *Damico* at 99. Per the Court's analysis, that lack of meaningful choice is essentially the definition of unconscionability when coupled with oppressive terms. *See Damico* at 98 (explaining "unconscionability is defined 'as the absence of meaningful choice on the part of one party due to one-sided contract provisions, together with terms which are so oppressive that no reasonable person would make them and no fair and honest person would accept them'") (quoting *Fanning v. Fritz's Pontiac-Cadillac-Buick, Inc.*, 322 S.C. 399, 403, 472 S.E.2d 242, 245 (1996)). To determine "meaningful choice," the Court addressed the "relative disparity in the parties' bargaining power, the parties' relative sophistication, and whether the plaintiffs are a substantial business concern of the defendant." *Damico* at 98 (citing *Simpson v. MSA of Myrtle Beach, Inc.*, 373 S.C. 14, 25, 644 S.E.2d 663, 669 (2007)).

Relying on *Simpson* and other consumer-protection-based authority, the Court then stated: "[t]he distinction between a contract of adhesion and unconscionability is worth emphasizing: *adhesive contracts are not unconscionable in and of themselves* ***so long as the terms are even-handed.***" *Damico* at 101 (emphasis in original). The Court noted "unconscionability requires a finding of a lack of meaningful choice *coupled with* unreasonably oppressive terms. Thus, an adhesion contract with fair terms is certainly not unconscionable, and the mere fact a contract is one of adhesion does not doom the contract drafter's case." *Id.* (emphasis

in original).

Then, regarding the substance of the arbitration provision at issue, the Court explained that paragraphs 1, 4, and 5 of Section 16 of the sales agreements required the Court "to invalidate" the arbitration provision:

• Paragraph 1

The Court did not discuss Paragraph 1 in its analysis, but quoted portions of it in the introduction of the opinion. Paragraph 1 provides that "Disputes" are subject to binding arbitration and that Disputes between the parties are defined as involving many things, including disputes over any claims based in contract, warranty, statute, tort or otherwise and include disputes under the sale agreement, disputes related to the property at issue, and any warranties, personal injury, and property damage. *Damico* at 93.

• Paragraph 4

Paragraph 4 was the focus of the Court's analysis, which it dubbed "the most egregious term" of the arbitration clause. It provides: "Seller may, *at its sole election*, include Seller's contractors, subcontractors, and suppliers, as well as any warranty company and insurer as parties in the mediation and arbitration . . . the mediation and arbitration will be limited to the parties specified herein." *Damico* at 93 (emphasis added by court). Citing the Seventh Circuit and secondary sources, the Court explained the plaintiff is the "master of his own complaint and is the sole decider of whom to sue for his injuries." *Damico* at 102–103. The Court explained this paragraph impermissibly "strips Petitioners of" their legal right to decide "whom to sue" for alleged injuries. *Id.* at 102.

• Paragraph 5

The Court noted it was "equally concerning" that Paragraph 4, when read in conjunction with Paragraph 5, "creates the possibility of inconsistent factual findings that would preclude Petitioners from recovery on a purely procedural (rather than a merit) basis—a legal defense to which neither Lennar nor the other Respondents are entitled." *Damico* at 102. Paragraph 5 provides that "the parties agree no factual or legal finding made in arbitration is binding in any other arbitral or judicial proceeding 'unless there is mutuality of parties.'" *Id.* The Court expressed concern at the likelihood that Lennar would be unable, or possibly unwilling, to compel all defendants to arbitrate could result in an undesirable circumstance that would amount to preventing Petitioners from possibly litigating their claims fully. Indeed, the court explained its concern that an ar-

bitration proceeding could commence with only Lennar but without the other defendants, thus permitting Lennar to point the finger at non-participating subcontractors, while a circuit court proceeding could also permit subcontractors to point the finger at non-participating Lennar. The Court also noted that Paragraph 5, which "prevents any findings of fact or conclusions of law in the arbitration to be binding in any subsequent arbitral or judicial proceeding instituted by Petitioners to recover their damages fully," compounds the issue in that Petitioners "could not even use the fact that the arbitrator had found Lennar was not at fault"—hypothetically—"when pursuing liability against the remainder circuit court defendants, or vice versa." *Damico* at 103.

Moreover, given the current procedural posture of the underlying litigation in *Damico*, the Court noted that "the likelihood of inconsistent factual findings due to paragraphs 4 and 5 of the arbitration agreement—and the resultant, inherent unfairness to Petitioners" is actually "probable, rather than merely theoretically possible." *Damico* at 103. This is because the original developer and many of the subcontractors in the litigation "are not required to arbitrate with Lennar and Petitioners" for a number of different reasons, including the fact that some have no contract with Lennar, some have contracts executed after Petitioners filed their suit, and some have contracts with Lennar that do not contain an arbitration provision. *Id.*

Notably, this procedural posture is not particularly unique to the *Damico* case and can occur to varying degrees in construction defect lawsuits. But, the Court appears to have based its unconscionability assessment of Paragraphs 4 and 5—at least in part—on the current procedural status of the litigation and the impact that these paragraphs *could have* on the Petitioners' claims after a resulting (and hypothetical) trial and arbitration proceeding.

Severability Clause Deemed Unenforceable as a Matter of Public Policy

The Court then declined to sever the unconscionable portions of the arbitration provision, despite the fact that the arbitration section itself included the following severability language: "The wavier or invalidity of any portion of this Section shall not affect the validity or enforceability of the remaining portions of this Section." *Damico* at 104. The Court declined to sever the offending provisions for two reasons: (1) doing so would require blue penciling of a material term of the contract; and (2) public policy.

Of particular note is the Court's finding that the severability clause is "unenforceable as a matter of policy." *Damico* at 108. The Court reasoned that "honoring the severability clause here creates an incentive for Lennar and other home builders to overreach, knowing that if the contract is found unconscionable a narrower version will be substituted and enforced against an innocent, inexperienced homebuyer." *Id.* In reaching this conclusion, the court cites to a Florida Supreme Court case involving a nursing home's agreement with a patient, Georgia law on non-compete agreements in the employment context, and secondary source material similarly addressing the idea of "incentivizing" overreach, but all in the non-compete/employment context. *Id.* at 108–109. Quoting one of these secondary sources on non-competes, the Court even specifically substitutes the word "employees" with "[homebuyers]" and the word "employers" with "[home builders]," further drawing attention to the Court's determination that public policy in this state should likewise address and prevent this incentive in the context of residential construction and sale contracts. *Id.*

Finally, in the last section of its severance analysis, the Court reiterates that its decision is one based in consumer protection, reasoning that "South Carolina has an extensive history of expanding its common law on contracts so as to protect new homebuyers" and, thus, finding that "honoring the severability clause here . . .would violate public policy." *Damico* at 108–109. The Court bases its severability holding on the fact that the underlying contract is one of adhesion and "it is 'considerably doubtful' both parties truly intended a court to sever an unconscionable provision and enforce the remainder of the agreement," and that refusing to enforce the severance term will "hope[fully]" further public policy given the considerations "inherent in this type of consumer transaction (homebuying)." *Id.*

Conclusion

A clear and determinative theme of the Court's decision in *Damico* is consumer protection. For example (and as noted above), *Simpson v. MSA of Myrtle Beach, Inc.*, 373 S.C. 14, 644 S.E.2d 663 (2007) is cited throughout the opinion to support several key points of the Court's analysis. *Simpson* involved an arbitration provision in a contract involving the sale of a vehicle to a consumer. Similarly, *Doe v. TCSC, LLC*, 430 S.C. 602, 846 S.E.2d 874 (Ct. App. 2020) is cited several times to support the Court's severability analysis; *Doe*, like *Simpson* and others, also involved a contract for the sale of a vehicle to a consumer. Through these authorities and the Court's clear public policy declarations, at points the opinion almost seems to analyze the contract between Petitioners and Lennar as one that is closer to a consumer transaction for goods (i.e. buying a car from a car dealership) instead of a contract for the sale of a home or a service contract for construction of a home. The Court even cites to statutory and case law addressing the unconscionability standards under the Uniform Commercial Code for contracts as a whole and clauses within said contracts, when governed by Article 2 of the UCC. *See, e.g., Damico* at 105. Moreover, the Court also analogizes the public policy incentives here as being comparable to those involved in non-compete agreements in employment law matters.

Even so, the Court has expressed a preference that a consumer who comes to the table to contract with a homebuilder for a new home may be afforded some sort of policy-based consumer protection. Whether the public policy standards articulated by the Court in *Damico* will significantly impact the law in this area remains to be seen, however, given that the analysis will always first be predicated on a case-by-case, contract-by-contract interpretation of the facts and terms.

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Celebrate Pro Bono Week

Celebrate Pro Bono Week was October 24-30, 2022. The Pro Bono committee hosted a lunch-and-learn event on October 24th and Tuesday, October 31 from noon to 1:30 p.m. at the SC Bar Conference Center. Attendees had an opportunity to participate in quick training sessions on topics to include Family Law: Child Custody & Visitation, Wills/POA, Business Formation, and Landlord/Tenant Law. Sign up for the Oct. 31 event here.

Several non-profits from across the state, including Sistercare, ProjectHELP, and the Appleseed Justice Network attended to share more information with attendees about ways to get involved.

The YLD's Pro Bono Day will be **Saturday, November 12 from 12-3 p.m.**, when the Pro Bono Committee will host members who have participated in training and/or have experience with family law, estate planning, and landlord/tenant law to provide qualified registrants with pro bono legal services. **More information registration will be available November 1.**
The committee is encouraging all YLD members to commit to providing at least two hours of pro bono legal assistance through the end of 2022.

Call for Nominations

The Young Lawyers Division invites nominations for its positions of President-Elect, Secretary-Treasurer, Out-of-State Representative and Odd-Numbered Judicial Circuit Representatives. These positions will become available June 30, 2023. For eligibility requirements, see the YLD Bylaws, available on the YLD website at here. To nominate yourself or someone else for a position, please submit a nomination letter to Kimberly Snipes at ksnipes@scbar.org by **October 31.**

Stars of the Quarter

Lisa Bisso
Jessica Ferguson
Greg Parker
Mike Martinez
Elizabeth Millender
Beth Bowen
Will Yarborough
David A. Nasrollahi
TJ Twehues
Alec Hogsette
Johanna Menke
Osbelkis Perez

Letter from the President

Dear Young Lawyers:

I hope this issue of *South Carolina Young Lawyer* finds you well and enjoying the early days of fall. As you likely already know, July 1 marked the beginning of the South Carolina Bar's 2022–2023 fiscal year. I am excited and honored to serve as your YLD President this year. I promise to do my best to continue to improve upon the YLD's incredible history of service to both the public and the profession. I am so very lucky to follow in the footsteps of Immediate Past President Jeanmarie Tankersley—one of the most exceptional leaders I've ever had the pleasure of working with. Jeanmarie led the YLD with enthusiasm and grace, navigating the ongoing effects of the COVID-19 pandemic and working tirelessly to re-engage the organization's membership. I am thrilled to work alongside President-Elect Taylor Gilliam and Secretary-Treasurer Mike Burch—two outstanding leaders not only in the YLD but in the profession and community generally—and have the assistance of an amazing group of Circuit Representatives and Committee Chairs to round out this year's leadership team. Also, if you have not introduced yourself to our Bar Liaison extraordinaire, Kimberly Snipes, please do so, as she is the go-to person for SC Bar knowledge, and we are incredibly lucky to have her as part of our team.

Your YLD leaders have been working diligently to develop programs and events that are certain to benefit you both personally and professionally this year. And, with your help, the YLD is already off to a great start. The Backpack Drive Committee just wrapped up a record-setting school supply drive. The Community Law Week Committee, for Constitution Day, coordinated with schools across the state to have young lawyer volunteers speak with students about the history and importance of the Constitution. Keep an eye out in the bi-monthly YLD Announcements for information regarding upcoming programs and volunteer opportunities offered by the Wills Clinic, Pro Bono & Community Outreach, Voices Against Violence, Protecting Our Youth, Diversity, and Make-A-Wish committees, to name a few. Thank you to all those who have participated and will continue to participate in YLD programming.

Lastly, if you haven't already, please sign up for a YLD committee today! The YLD is your organization, and involvement in it is a great way to enhance your fulfillment with the practice of law by helping the community at large, getting to know fellow lawyers, building your professional network, and developing lifelong friendships. I believe the YLD has something for everyone, but if you disagree, I would love for you to bring your ideas to Taylor, Mike, and me. I look forward to another wonderful bar year and all that we will accomplish together!

Sincerely yours,

(signature is coming)

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