THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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APPEAL FROM CHARLESTON COUNTY
Court of Common Pleas

Mikell R. Scarborough, Master in Equity



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Case No. 2016-CP-10-1143
[Appellate Case No. 2016-002308]

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Palmetto Construction Group, LLC — Respondent

v.

Restoration Specialists, LLC,
Reuben Mark Ward, and
Lynnette Pennington Ward — Appellants

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# INITIAL BRIEF OF APPELLANTS

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## STATEMENT OF THE CASE

This action arises out of a construction project in Augusta, Georgia. The

Respondent and Appellant Restoration Specialists, LLC ("Appellant Restoration") entered into a Subcontract Agreement in connection with the Project. Respondent filed this lawsuit on March 7, 2016, alleging a breach of the Subcontract Agreement. *(Summons and Complaint, with Exhibits).* Simultaneously with filing the lawsuit, Respondent filed a Motion to Stay and to Compel on March 7, 2016. *(Plaintiff's Motion to Stay and to Compel).* The basis of Respondent's Motion to Stay and to Compel was that the Subcontract Agreement contained mandatory mediation/arbitration provisions requiring the Court to stay the litigation and the parties to mediate in Georgia or other agreed upon location and, if necessary, arbitrate all claims contained in Respondent's lawsuit. *(Id.)*

Respondent simultaneously served all Appellants with both the Complaint and Motion to Stay and to Compel on March 14, 2016. *(Motion to Refer to the Master In Equity and for Entry of Default).*

Respondent filed a Motion to Refer to the Master in Equity and for Entry of Default on April 18, 2016. *(Id.).* The Circuit Court entered default against the Appellants on April 21, 2016. *(Order of April 20, 2016).*

On the evening of June 2, 2016, the Appellants were served with a Notice of Hearing scheduling the default damages hearing for June 6, 2016. *(Affidavit I of Reuben Mark Ward of June 3, 2016 and Notice of Hearing of June 1, 2016).* The Appellants were unaware of the default status of the case and the scheduling of the damages hearing until they received this hearing Notice on June 2, 2016. *(Affidavit II of Reuben Mark Ward of June 3, 2016).* Upon receipt of this Notice of Hearing, the Appellants immediately retained legal counsel on June 3, 2016. *(Id.).* Appellants' counsel immediately filed a Motion for Continuance of the damages hearing and a Motion to Set Aside Entry of Default on June

3, 2016, citing the mandatory mediation/arbitration provisions and Respondent's Motion to Stay and Compel mediation/arbitration as one of their grounds for relief. *(Defendants' Notice of Motion and Motion for Continuance and Protection Pursuant to SCRCP 6(d) and 40 (i) and Defendants' Notice of Motion and Motion to Set Aside Entry of Default Pursuant to SCRCP 55(c))*.

At the hearing on June 6, 2016, the Master in Equity ("Master") granted Appellants' Motion for Continuance of the damages hearing and held the Motion to Set Aside Entry of Default in abeyance. *(Transcript of Proceedings Held June 6, 2016 p. 11 line 18 – p. 12 line 4)*. The Master then directed the Appellants to provide financial information relative to the Project to see what could be resolved between the parties and scheduled the matter to reconvene for a status conference on July 14, 2016. *(Id. p. 12 line 6 – 20)*. Per the Master's direction, the Appellants provided certain relevant documents and basic written discovery responses to Respondent.

On July 11, 2016, the Appellants filed a formal Motion to Stay and to Compel on the basis of the mandatory contractual mediation/arbitration provisions. *(Defendants' Notice of Motion and Motion to Stay and to Compel Pursuant to SCRCP 12(b)(2) and Applicable Case Law)*. In addition, the Appellants joined in and consented to Respondent's Motion to Stay and to Compel, rendering that motion a joint Motion to Stay and to Compel mandatory mediation/arbitration ("Joint Motion"). *(Id.)*. As such, Appellants' singular and joint Motions to Stay and Compel mandatory mediation/arbitration were pending before the Master at this time.[1]

[1] While Respondent asserts that it "set aside" or "withdrew" its Motion to Stay and Compel, Appellants have not been provided a copy of documentation reflecting Respondent's setting aside or withdrawal of said motion, and, there is likewise nothing in the record substantiating same.

The parties reconvened before the Master on July 14, 2016. *(Transcript of Proceedings Held July 14, 2016).* The Appellants also filed a Memorandum in Support of their Motion to Lift Entry of Default on July 14, 2016, which included Appellants' continued assertion of their right to arbitration. *(Memorandum in Support of Defendants' Motion to Set Aside Entry of Default Pursuant to SCRCP 55(c)).* During the reconvened hearing the Master stated that the Clerk of Court "closed out" the Respondent's Motion to Stay and Compel. *(Transcript of Proceedings Held July 14, 2016 p. 9 line 5-7).* The Clerk's closure of the motion occurred despite Appellant's joinder in the motion. The Master issued a bench ruling finding that the Clerk's action constituted an adjudication of this motion. *(Id. p. 9 line 8-9).* The Master further ruled from the bench finding Appellants in default, denying Appellants' Motion to Lift Entry of Default and scheduling a default damages hearing for October 4, 2016. *(Id. p. 9 line 12 – 17 and p. 12 line 7-8).*

Upon completion of the reconvened hearing, the Master issued a formal order dated July 14, 2016. *(Order of July 14, 2016).* The Master's formal order: (a): Denied Appellants' Motion to Lift Entry of Default for lack of good cause; (b): Denied Appellants' Motion to Stay and Compel mandatory mediation/arbitration on the basis of default; and (c): Set a damages hearing for October 4, 2016. *(Id.).* Appellants received written notice of entry of these orders on July 18, 2016. *(Emails, with Cover Letter, filed with the Court on July 22, 2016).*

The Appellants filed a timely Motion to Reconsider and to Alter and Amend the Master's orders pursuant to SCRCP 59(e) and applicable case law on July 27, 2016. *(Defendants' Notice of Motion and Motion to Reconsider and to Alter or Amend Pursuant to SCRCP 59(e) and Applicable Case Law).* The Master scheduled the hearing on

Appellants' Rule 59(e) motion to be held on October 11, 2016, seven days after the scheduled damages hearing on October 4, 2016. *(Charleston County Roster Details – Master's Docket for October 11, 2016.)*.

On September 7, 2016 standing on their rights to mandatory mediation/arbitration, the Appellants requested in writing that the Master schedule the hearing on Appellants' Rule 59(e) motion prior to the October 4, 2016 damages hearing. *(Attorney Ariail Letter to Judge Scarborough of September 7, 2016 received by the Court on September 13, 2016)*.

On September 7, 2106, the Master replied to Appellants' request and made the decision to switch the hearing dates, with the motions hearing to be held on October 4, 2016 and, if necessary, the damages hearing to be held on October 11, 2016. *(Emails, with Cover Letter, filed with the Court on September 22, 2016)*. The Master asked the parties to advise if this plan was acceptable. *(Id.)* The Appellants informed the Master that this plan was acceptable. *(Id.)*. The Respondent notified the Master that it would defer to the Master, but preferred the damages hearing to proceed on October 4, 2016 and the motions hearing to be held thereafter on October 11, 2016. *(Id.)*.

After further consideration, the Master then rendered a decision not to switch the hearing dates and informed the parties that the damages hearing would proceed on October 4, 2016 and the motions hearing would be held on October 11, 2016. *(Id.)*. The Appellants received written notice of the Master's decision on September 12, 2016. *(Id.)*.

The Master's decision to proceed with the damages hearing and not hear the Appellants' Rule 59(e) motion prior thereto effectively denied this motion as proceeding with the damages hearing under these circumstances would severely prejudice, and potentially force a waiver of Appellants' rights to arbitration and foreclose any appeal

therefrom. Therefore, subject to, without waiving and fully reserving their rights to arbitration, the Appellants commenced an appeal in this matter on September 30, 2016. *(Notice of Appeal).*

On September 30, 2016, after service of the Notice of Appeal on Respondent, the Appellants filed the Notice of Appeal with the Charleston County Clerk of Court. *(Letter from Law Office of A. Bright Ariail, LLC to Charleston County Clerk of Court).* On October 3, 2016, the Respondent filed its first Motion to Dismiss Appeal. *(Respondent's Emergency Motion to Dismiss Appeal and for Expedited Review, dated October 3, 2016).* The Court of Appeals returned Respondent's first Motion to Dismiss on October 4, 2016 because no Notice of Appeal had been filed with the Court of Appeals as of that date. *(Court of Appeals Letter to Respondent).*

On October 5, 2016, the Appellants filed the Notice of Appeal, along with the filing fee and copies of the orders challenged on appeal with the Clerk of the Court of Appeals. *(Attorney Ariail Letter to Court of Appeals, with Exhibits).* The copies of the orders filed with the Clerk of the Court of Appeals included the Master's Bench Order contained in the transcript of the July 14, 2016 hearing and the Master's formal written order dated July 14, 2016. *(Id.).* The Appellants simultaneously served the Respondent with a copy of the October 5, 2016 filing with the Clerk of the Court of Appeals on October 5, 2016. *(Id.).*

On October 6, 2016, the Appellants refiled the Notice of Appeal, along with a second filing fee and copies of the orders challenged on appeal with the Clerk of the Court of Appeals. *(Attorney Ariail Letter to Court of Appeals, with Exhibits).* The Appellants refiled these documents to include the court reporter's certification of the July 14, 2016 hearing transcript containing the Master's bench order. *(Id.).* The court reporter's

certification had been inadvertently omitted from the Appellants' October 5, 2016 filing with the Clerk of the Court of Appeals. *(Id.)*. The Appellants simultaneously served the Respondent with a copy of the October 6, 2016 filing with the Clerk of the Court of Appeals on October 6, 2016. *(Id.)*.

Although this case was under appeal, the Master notified all parties that he intended to go forward with the hearing set for October 4, 2016. *(Emails, with Cover Letter, filed with the Court on October 4, 2016)*. During that hearing, the Master did not proceed with the damages hearing nor issue a ruling on the Rule 59(e) motion, but stated that he wished to establish a record for appellate court review of this matter. *(Transcript of Proceedings Held October 4, 2016 p. 9 lines 14-19)*. Accordingly, the Master accepted Appellants' Memorandum in Support of Defendant's Motion to Reconsider and to Alter or Amend *(Memorandum in Support of Defendant's Motion to Reconsider and to Alter or Amend Pursuant to SCRCP 59(e) and Applicable Case Law)*, discussed the procedural posture of the case *(Transcript of Proceedings Held October 4, 2016 p. 1-10)*, allowed the parties to proffer information related to Appellants' Motion to Reconsider and to Alter or Amend *(Id. p. 10 – 26)* and allowed Respondent to proffer information related to damages alleged *(Id. p. 26 – 28 and p. 31 - 32)*, to which Appellants' vehemently objected *(Id. p. 29 -31)*. Further, the Court asked Respondent to provide a responsive memorandum to Appellants' Rule 59(e) motion within ten (10) days, and allowed Appellants' five (5) days to reply *(Id. p. 22 and 31-32)*. Respondent filed its memorandum in opposition on October 26, 2016 *(Plaintiff's Opposition to Defendants' Motion to Reconsider Alter or Amend)* and Appellants replied thereto on October 25, 2016. *(Defendants' Reply to Respondent's Opposition to Defendants' Motion to Reconsider Alter or Amend)*.

On October 27, 2016, the Respondent filed its second Motion to Dismiss Appeal. *(Respondent's Motion to Dismiss Appeal and for Expedited Review, dated October 27, 2016).* Thereafter, on November 10, 2016, the Court of Appeals issued an order stating that based on the Master's actions at the October 4, 2016 hearing, it appeared the Master intended to issue a final written order on the Rule 59(e) motion. *(Order of November 10, 2016).* Accordingly, the Court of Appeals dismissed Appellants' initial appeal without prejudice ruling that the Appellants could appeal after the Master's issuance of a final, written order on the Rule 59(e) motion. *(Id.).*

On October 28, 2016, the Master issued an order ruling on Appellants' motion to reconsider pursuant to Rule 59, SCRCP. *(Order of October 28, 2016).* The Master's Order: (a): Denied Defendants' Motion to Amend on the basis that Defendants did not show good cause to lift the default, and (b): Denied Defendants' Motion to Stay and Compel filed July 11, 2016 on the basis that the affirmative defense of arbitration had been waived and therefore the motion was not properly made. *(Id.)* Appellants received written notice of entry of this order on November 2, 2016. *(Notice of Appeal).*

The Appellants commenced the instant appeal on November 14, 2016, appealing the Orders of the Honorable Mikell R. Scarborough dated July 14, 2016 and October 28, 2016. *(Id.).* On December 2, 2016, the Respondent filed a Motion to Dismiss Appeal. *(Respondent's Motion to Dismiss Appeal, dated December 2, 2016).* Thereafter, the parties fully briefed Respondent's motion and, on February 1, 2016, the Court of Appeals issued an order denying Respondent's Motion to Dismiss Appeal and directing Appellants to file their initial brief and designation of matter. *(Order of February 1, 2016).*

## FACTS

This case arises out of a construction project in Augusta, Georgia. *(Complaint p. 2).* On March 29, 2012, the Appellant, Restoration Specialists ("Appellant Restoration") was awarded a contract to construct the Charlie Norwood VAMC Parking Garage in Augusta, Georgia. ("the Norwood Parking Garage Project" or the "Project"). *(Memorandum in Support of Defendants' Motion to Set Aside Entry of Default Pursuant to SCRCP 55(c)).* Prior to the contract award, the Respondent entered into a Teaming Agreement with Appellant Restoration in December 2011 *(Complaint, Exhibit B).* The Respondent entered into a Subcontract Agreement with Appellant Restoration on September 10, 2014 in connection with the Project. *(Complaint, Exhibit A.)*

Respondent's Complaint alleges that Appellant Restoration has failed to pay the contract balance due under the Subcontract Agreement and asserts additional claims relating to the Project against the Appellants, Reuben Mark Ward and Lynnette Pennington Ward ("Ward Appellants") *(Complaint).*

## ARGUMENTS

I. BECAUSE GOOD CAUSE EXISTS FOR RELIEF FROM THE ENTRY OF DEFAULT, THE COURT ERRED WHEN IT DENIED APPELLANTS' MOTION TO SET ASIDE ENTRY OF DEFAULT.

**(A): Appellate Standard Of Review.**

The decision whether to set aside an entry of default lies solely within the sound discretion of the circuit court. *Harbor Island Owners' Ass'n v. Preferred Island Props.*, 369 S.C. 540, 544, 633 S.E. 2d 497, 499 (2006). The circuit court's decision will not be disturbed on appeal absent a clear showing of an abuse of that discretion. *Mitchell Supply Co., Inc. v. Gaffney*, 297 S.C. 160, 162-63, 375 S.E. 2d 321, 322-23 (Ct. App. 1988). An

abuse of discretion occurs when the judge issuing the order was controlled by some error of law or when the order, based upon factual, as distinguished from legal conclusions, is without evidentiary support. *In re Estate of Weeks*, 329 S.C. 251, 259, 495 S.E. 2d 454, 459 (Ct. App. 1997).

**(B): The Standard For Granting Relief From An Entry Of Default Under Rule 55(c), SCRCP Is Mere Good Cause.**

The standard for granting relief from an entry of default under Rule 55(c), is mere "good cause." Rule 55(c), SCRCP. *White Oak Manor, Inc. v. Lexington Ins. Co.*, 407 S.C. 1, 753 S.E. 2d 537 (2014). This standard requires a party seeking relief from an entry of default under Rule 55(c) to provide an explanation for the default and give reasons why vacation of the default entry would serve the interests of justice. *Sundown Operating Co. v. Intedge Indus., Inc.*, 383 S.C. 601, 607, 681 S.E. 2d 885, 888 (2009). Once a party has put forth a satisfactory explanation for the default, the trial court must also consider: (1) the timing of the motion for relief; (2) whether the defendant has a meritorious defense, and (3) the degree of prejudice to the plaintiff if relief is granted. *Id.* at 607-08, 681 S.E. 2d at 888.

The law does not favor defaults. Therefore, in applying this standard, Rule 55(c) "is liberally construed to promote justice and dispose of cases on the merits." *Dixon v. Besco Engineering, Inc.*, 320 S.C. 174, 178, 463 S.E. 2d 636, 638 (Ct. App. 1995).

**(C): The Appellants' Rights To Mandatory Mediation/Arbitration Under The Contract Constitute Good Cause For Relief From The Entry Of Default.**

In the present case, the contract giving rise to this action requires all claims arising out of or related to the contract to be mediated, and if not resolved by mediation, to be

resolved by binding arbitration. Pursuant to these provisions, and contemporaneously with the commencement of this action, the Respondent made and served upon Appellants a demand for mandatory mediation/arbitration in its Motion to Stay and Compel. By doing so, the Respondent informed Appellants that it had made a demand for mandatory mediation/arbitration of this dispute under the terms of the contract. Respondent's demand also triggered the requirements of the South Carolina Uniform Arbitration Act and/or Federal Arbitration Act mandating a stay of this action and compulsory mediation/arbitration. Respondent's demand was consistent with the parties' rights to arbitration under the contract and Appellants' reliance thereon was justified.

Within twenty-four (24) hours of learning of Respondent's application for default and the entry of default against them, the Appellants immediately moved to be relieved from default, citing the mandatory mediation/arbitration provisions and Respondent's Motion to Stay and Compel mediation/arbitration as a grounds for relief. Appellants filed their Motion to Lift Entry of Default within one and a half (1 ½) months of the entry of default. Also, Appellants formally joined in Respondent's motion and filed a separate Motion to Stay and Compel mandatory mediation/arbitration less than four (4) months after Respondent's commencement of suit.

The Court's good cause analysis must include the application of the proper legal standards to these contract provisions as well as the question of waiver/default of the arbitration rights thereunder. The proper legal standards are discussed in the *Initial Brief of Appellants, Arguments Section II (E) (2)* below. Applying any other standards would be an error of law and modify the long standing arbitration jurisprudence of South Carolina, the United States District Court for the District of South Carolina and the Fourth

Circuit Court of Appeals.

Applying the proper legal standard to the evidence on record establishes that the mandatory mediation/arbitration provisions apply to the Respondent's claims and that the Appellants have neither waived nor defaulted upon their rights to arbitration. *See Arguments Section II.*

Since there has been no waiver or default upon Appellants' rights to mandatory mediation/arbitration, the Court is required to stay this litigation and submit the matter to mediation/arbitration. *See Initial Brief of Appellants, Arguments Section II.* Furthermore, by virtue of this requirement to stay the litigation and compel arbitration, the Court must divest itself of subject matter jurisdiction upon submission to mediation/arbitration. *See Initial Brief of Appellants, Arguments Section II.*

Standing alone, these facts and the legal conclusions arising therefrom constitute good cause for lifting the entry of default, staying this action and compelling mandatory mediation/arbitration. *See Rule 55(c), SCRCP; see also Initial Brief of Appellants, Arguments Section II.*

The Master's failure to apply the proper legal standards governing the arbitration rights of the Appellants constitutes an error of law and abuse of discretion under Rule 55(c), SCRCP. Therefore, the Master's Orders of July 14, 2016 and October 28, 2016 should be reversed and the Appellants should be relieved from default.

**(D): The Appellants' Provided A Satisfactory Explanation For The Default And Vacation Of The Entry Of Default Will Serve The Interests Of Justice And Reverse The Error Of Law Regarding Appellants' Arbitration Rights.**

The Appellants did not file a timely response to the complaint due to an unintentional

and good faith misunderstanding of the status of Appellants' arrangements with The Hanover Insurance Company ("Hanover") and the relation of Respondent's lawsuit thereto. (*Affidavit II of Reuben Mark Ward of June 3, 2016*).

Hanover is the surety under the Payment Bond on the Project referenced by Respondent in its Complaint (*Complaint*). Respondent references an indemnity agreement with Hanover in its Complaint and alleges that the Appellants must indemnify the surety and Respondent to the extent it is required to pay. (*Id.)* Respondent further claims that, due to Appellants' alleged failure to pay the contract balance due, claims have been made by other subcontractors upon the Payment Bond and as a consequence subcontractors are making claims against Respondent and its surety, Hanover. (*Id.)*

Based on these allegations in the complaint, the Appellants did not understand that Plaintiff's lawsuit was separate and apart from the bond claims that they had been working directly with Hanover to address. The Appellants are not attorneys, are unversed in the procedural rules of court and assumed the lawsuit was being handled as part and parcel of their arrangements with Hanover.

The Appellants' misunderstanding in this regard was innocent and carried no intention of gaining an unfair advantage over the Respondent or delaying legal proceedings. Upon learning of their error, Appellants immediately retained legal counsel to appear and respond on their behalf in this matter.

Furthermore, the law does not favor defaults. As such, Rule 55(c) is liberally construed to promote justice and dispose of cases on the merits. *Dixon v. Besco Engineering, Inc.*, 320 S.C. 174, 463 S.E. 2d 636. The Appellants' short delay in making their appearance and responding to Respondent's lawsuit constitutes no prejudice to

Respondent. *See Initial Brief of Appellants, Arguments Section II (G).* Also, the Appellants have asserted various defenses to Respondent's lawsuit, which if prevailed upon, would render a verdict contrary to the result reached by the entry of default. *See Initial Brief of Appellants, Arguments Section II (F).* Finally, the Appellants are entitled to mandatory mediation/arbitration and the Master's finding of a default or waiver of these rights due to the entry of default or waiver of affirmative defenses is an abuse of discretion under Rule 55(c), and, therefore, reversible error.

For these reasons, vacating the entry of default is proper and would serve the interests of justice and promote disposition of the case on the merits.

**(E): The Appellants Promptly And Timely Filed Their Motion Seeking Relief From The Entry Of Default.**

The Respondent filed a Motion to Refer to the Master in Equity and for Entry of Default on April 18, 2016. Thereafter, the Court entered default against the Appellants on April 21, 2016.

On the evening of June 2, 2016, the Appellants were served with a Notice of Hearing scheduling the default damages hearing for June 6, 2016. The Defendants were unaware of the default status of the case and the scheduling of the damages hearing until they received this Notice of Hearing on June 2, 2016.

Upon receipt of the Notice of Hearing, the Appellants immediately retained legal counsel on June 3, 2016. Appellants' counsel immediately filed a Motion for Continuance of the damages hearing and a Motion to Set Aside Entry of Default on June 3, 2016.

As established by the above timeline, the Appellants took immediate action upon learning of the default status and receipt of the Notice of Hearing for the damages hearing.

This action included the retention of defense counsel within 24 hours of becoming aware of the default status and damages hearing followed by the immediate filing of the Motion to Set Aside Entry of Default. Thus, the Appellants satisfied the good cause timely motion filing requirement of Rule 55(c), SCRCP.

**(F): The Appellants Are Entitled to Mandatory Mediation/Arbitration Of This Matter and Have Meritorious Defenses To The Plaintiff's Lawsuit.**

The Appellants are entitled to mandatory mediation/arbitration of the claims in Respondent's lawsuit for the reasons set forth in the *Initial Brief of Appellants, Arguments Section II.* In addition, the Appellants have asserted further substantive defenses to Respondent's claims as raised in their Motion to Lift Entry of Default and set forth below:

(1): Respondent has been paid in full under the Subcontract Agreement, including an overpayment in excess of Fourteen Thousand ($14,000.00) Dollars;

(2): There is no agreement for profit sharing between the parties. Per the Teaming Agreement, entered into between Respondent and Appellant Restoration in connection with the Project, "[n]othing herein shall be construed as providing for the sharing of profits or losses arising out of the efforts of either or both of the Parties; except as may be provided for in any resultant contractual arrangement agreed to between the Parties." (*Complaint, Ex. B*). Further, there is nothing in the Subcontract Agreement between the parties related to the project that allows for profit sharing *(Complaint, Ex. A)*;

(3): The Payment Bond delineates the obligation for payment of Project subcontractors and vendors as that of Restoration, as Principal, and The Hanover Insurance Company, as Surety. (*Complaint Ex. C*). Appellants dispute the claims made by many of the subcontractors which have made claims against the Payment Bond;

(4): Appellant Restoration has not paid all subcontractors and vendors in full as the Department of Veterans' Affairs has not made final payment under the Contract;

(5): The Teaming Agreement includes a waiver of damages, specifically: "ARTICLE 9 DAMAGES – Neither Party shall be liable to the other for any indirect, special or consequential losses, whether arising in contract, tort (including negligence), or otherwise." (*Memorandum In Support of Defendants' Motion to Set Aside Entry of Default Pursuant to SCRCP 55(c)).*

If Appellants prevail on any of the above-enumerated defenses, the outcome would be contrary to the result rendered by the entry of default. Therefore, the Appellants have set forth a meritorious defense sufficient to satisfy the good cause standard of Rule 55(c), SCRCP.

**(G): The Respondent Will Not Suffer Prejudice If The Court Lifts The Entry Of Default And/Or Stays The Action And Compels Mandatory Mediation/Arbitration.**

The Appellants responded to Respondent's lawsuit with the retention of counsel and filing of a Motion to Set Aside Entry of Default on June 3, 2016. The Appellants took these actions within 51 days of the date on which Appellants' answer to the Complaint was originally due, within 43 days of the entry of default, and within 24 hours of first learning of the default status and damages hearing. The Appellants' brief delay was short and creates no prejudice to the Respondent's ability to litigate the case. This brief delay has caused no actual prejudice to Respondent such as loss of evidence, increased difficulties of discovery, opportunity for fraud or collusion, or undue expense or damage to the Respondent's legal position.

Respondent attempts to claim prejudice through its' counsel's statements in

Respondent's memorandum in opposition to Appellants' Rule 59(e) Motion to Reconsider Alter or Amend. Specifically, Respondent's counsel states that "Palmetto would be severely prejudiced if the default were lifted as the passage of time pushed Palmetto closer to closing their doors, and further, Palmetto has taken actions, like withdrawal of its motion to compel arbitration and referral of the action to the Master in Equity, as a result of [Appellants] failure to timely answer." *(Palmetto Construction's Opposition To Defendants' Motion to Reconsider Alter or Amend).*

The statement related to Respondent "closing [its] doors" is a bald assertion of its counsel and is not supported by evidence in the record. Proof of prejudice cannot be speculative, nor based on conclusory allegations. *General Equip. & Supply Co., Inc. v. Keller Rigging & Constr., Inc.*, 344 S.C. 553, 544 S.E. 2d 643 (Ct. App. 2001); *Patten Grading & Paving, Inc. v. Skanska USA Bldg., Inc.*, 380 F. 3d 200 (4th Cir. 2004)*; see also Initial Brief of Appellants, Arguments Section II (and cases cited therein).*

Respondent's remaining claims of "prejudice" proffered by its' counsel's allegations in the referenced legal memorandum refer to activities which are either not supported by the record or are nominal at best and insufficient to establish actual prejudice under applicable law. *See id.*

Furthermore, the Respondent itself demanded mandatory mediation/arbitration of its claims at the time it filed its lawsuit. Certainly, it cannot now reverse its position and complain of any prejudice which would result from setting aside the default and submitting the claims to mediation/arbitration.

In fact, the corollary to the lack of prejudice to the Respondent is the extreme prejudice the Appellants will suffer if the default is not lifted and the court proceeds with

a default damages hearing. In this circumstance, the Respondent will have received significant undue advantage in achieving a default based litigation result that is not based on the merits of the case. Moreover, this result will obtain in a case Respondent acknowledges is governed by contractually agreed upon mandatory mediation/arbitration and over which the court is mandated to cede jurisdiction to the arbitration forum. This extreme prejudice will be further magnified by the significant limitations and restrictions imposed upon Appellants' rights to defend against Respondent's claims in the damages hearing forum.

For these reasons, and as no prejudice will result to Respondent in setting aside the entry of default, this good cause factor under Rule 55(c), SCRCP is satisfied.

II. BECAUSE THE CONTRACT CONTAINS MANDATORY MEDIATION/ARBITRATION PROVISIONS AND THE APPELLANTS HAVE NOT DEFAULTED UPON NOR WAIVED THEIR RIGHTS TO MEDIATION/ARBITRATION, THE COURT ERRED WHEN IT FAILED TO STAY THIS ACTION AND COMPEL MEDIATION/ARBITRATION.

**(A): Appellate Standard of Review.**

The denial of a motion to compel arbitration, based on a finding of waiver, is a legal conclusion subject to *de novo* review on appeal. *Carlson v. S.C. State Plastering, LLC*, 404 S.C. 250, 743 S.E. 2d 868 (Ct. App. 2013); *MailSource, LLC v. M.A. Bailey & Assoc.*, 356 S.C. 370, 374, 588 S.E. 2d 639, 641 (Ct. App. 2003).

**(B): Public Policy Supports Contractually Agreed Arbitration.**

The parties' contract is clearly an integrated and executed written agreement whereby Respondent and the Appellants agreed to resolve their disputes through mandatory mediation, and if necessary, through arbitration. *Standard Form of Agreement Between Contractor and Subcontractor Dated September 10, 2014*; *see also Arguments*

*Section II (C)*. Pursuant to South Carolina Code Annotated §15-48-10, such an agreement is "valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract." South Carolina Code Ann. § 15-48-10. Likewise, under federal law such an agreement is "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.

Moreover, "the policy of the United States and South Carolina is to favor arbitration of disputes." *Tritech Elec. v. Frank M. Hall & Co.*, 343 S.C. 396, 540 S.E. 2d 864 (Ct. App. 2000) (quoting *Heffner v. Destiny, Inc.*, 321 S.C. 536, 537, 471 S.E. 2d 135, 136 (1995). Further, South Carolina and federal courts resolve any doubts concerning the scope of arbitrable issues in favor of arbitration. *See Bazzle v. Green Tree Financial Corp.*, 351 S.C. 244, 569 S.E. 2d 349 (2002); *Towles v. United Healthcare Corp.*, 338 S.C. 29, 524 S.E. 2d 839 (Ct. App. 1999); *see also Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983) ("[A] as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself *or an allegation of waiver, delay, or a like defense...*") ( emphasis added).

Given both the United States and South Carolina's well recognized and articulated preference for arbitration, and the fact that the parties entered into a written agreement to arbitrate all disputes arising out of or related to the contract, the South Carolina Court of Appeals should reverse the lower court's ruling and stay this action and compel the matter to mandatory mediation/arbitration.

**(C): All Appellants Are Entitled to Mediation/Arbitration Under the Alternative Dispute Resolution Provisions of the Contract.**

The Respondent's Complaint and the causes of action asserted against all Appellants, including the individual Appellants, Reuben Mark Ward and Lynnette Pennington Ward ("Ward Appellants"), allegedly arise out of or are related to the contract containing the arbitration provisions. These provisions require all claims arising out of or related to the contract to be mediated, and if not resolved by mediation, to be resolved by binding arbitration.

Moreover, the arbitration provisions of the contract expressly allow for the joinder of non-signatories, such as the Ward Appellants, to the arbitration. Specifically, § 6.3.4 of the contract states in relevant part:

"Either party, at its sole discretion, may include by joinder persons or entities substantially involved in a common question of law or fact whose presence is required if complete relief is to be accorded in arbitration, provided that the party sought to be joined consents in writing to such joinder."

Based on the allegations in the Complaint, the Ward Appellants are first party Defendants substantially involved in common questions of law and fact whose presence is required for a complete resolution of this matter. The Ward Appellants consented in writing to their joinder in the arbitration in their Motion to Stay and to Compel Pursuant to SCRCP 12(b)(1) and Applicable Case Law. Specifically, the Ward Appellants stated in their motion:

"The Plaintiff has moved the Court to stay this action and compel mediation, and if necessary, arbitration by the parties to proceed as contractually required by the mandatory mediation/arbitration provisions contained in Article 6 of the contract. *The Defendants hereby join in and consent to Plaintiff's motion and the relief requested therein, including*

*the stay of this matter and submission of Plaintiff's claims to mediation and, if necessary, binding arbitration.*" (emphasis added).

Furthermore, the Respondent is equitably estopped from denying the applicability of the mandatory mediaion/arbitration clause as to all Appellants. The record establishes that Plaintiff initially acknowledged the validity of the arbitration provisions to all claims in this matter by filing its Motion to Stay and Compel at the commencement of this action. The Respondent's Motion to Stay and Compel demanded that all claims in this action, including Respondent's claims against the Ward Appellants, be stayed and compelled to mediation, and if necessary, to arbitration. "The very essence of equitable estoppel is to prevent a party from taking one position when it is to that party's advantage, and taking the opposite position when it is to that party's disadvantage." *See U.S. ex rel. Coast Roofing v. P. Browne & Assoc.*, 585 F.Supp 2d. 708, 715 (D.S.C. 2007). Thus, the fact that Respondent acknowledged the validity of the arbitration provision, as well as Appellants' standing to be involved in mediation and arbitration under that provision, "strongly speaks to both the provision's validity and [all of] the Appellants' standing to enforce the arbitration provision in the agreement." *See id.*

In addition to Respondent's own acknowledgement of the Appellants' standing under the arbitration clauses, the "intertwined claims" test further equitably estops Respondent from denying all Appellants, including the Ward Appellants, standing to enforce the arbitration provisions.

Under the intertwined claims test, "the circuits have been willing to estop a signatory from avoiding arbitration with a nonsignatory when the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped

party has signed.' *Id.* (quoting *Thomson-CSF, S.S. v. Am. Arbitration Assoc.*, 64 F.3d 773, 779 (2d Cir. 1995); *see also Choctaw Generation Ltd. P'ship v. American Home Assur. Co.*, 271 F. 3d 403, 406 (2d Cir. 2001)). To be equitably estopped from denying the applicability of an arbitration clause, the signatory need not necessarily assert a cause of action against the nonsignatory for breach of the contract containing the arbitration clause. *Id.* Instead, estoppel is appropriate if "in substance [the signatory's underlying] complaint [is] based on the [nonsignatory's] alleged breach of the obligations and duties assigned to it in the agreement." *Am. Bankers Ins. Group, Inc. v. Long*, 453 F.3d 623, 627-28 (4th Cir. 2006) (quoting *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F. 3d 753, 757 (11th Cir. 1993)).

Such is unquestionably the case here. While Respondent does not include a cause of action for breach of the Subcontract Agreement against the Ward Appellants in its Complaint, at the heart of its various claims against the Ward Appellants are its allegations that: (a) Respondent relied to its detriment on representations made by Appellant Mark Ward that he would manage the construction Project awarded under the primary contract and that all monies therefrom would be used to pay for material and labor supplied to the Project; and (b) all Appellants, including the Ward Appellants, are contractually bound to pay funds on claims made on the surety bond required by the primary contract for the Project. Therefore, it is clear that Respondent's claims are substantively "intertwined" with the obligations it alleges the Ward Appellants assumed in connection with the primary contract. *See U.S. ex. Rel. Coast Roofing*, 585 F. Supp 2d. 708.

Based on the above, as well as the remaining authorities cited below in the *Initial Brief of Appellants* all of the Appellants, including the Ward Appellants, have standing to

enforce the mandatory mediation/arbitration provisions and be involved in mediation and arbitration of the claims asserted in this matter. *Id.*

**(D): The Respondent's Motion To Stay And Compel, Which Motion The Appellants Joined In And Consented To, Should Be Properly Adjudicated And The Relief Requested Therein Granted.**

The Respondent filed and served a Motion to Stay and Compel mandatory mediation/arbitration contemporaneously with the commencement of this action. The Appellants joined in and consented to this motion as a part of their Motion to Stay and Compel filed on July 11, 2016, thus rendering the motion a joint motion for all parties to the case.

The Clerk of Court "closed out' this motion due to the referral of the case to the Master. *(Transcript of Hearing before the Honorable Mikell R. Scarborough on July 14, 2016 p. 9 line 8-9).* The Clerk's closure of the motion occurred despite Appellants' formal joinder in the motion. The Master issued a bench ruling, finding that the Clerk's action constituted an adjudication of this motion. *Id.* The Master's ruling became final in his written order denying Appellants' Motion to Stay and Compel dated July 14, 2016. The summary closure of this joint motion as an administrative matter and the Master's "adjudication" of this motion on that basis does not constitute a proper adjudication of this motion nor a valid basis for waiver of Appellants' arbitration rights. *See General Equipment v. Keller Rigging,* 344 S.C. 553, 544 S.E. 2d 643 (Ct. App. 2001) (finding that the referral of a case to the Master-in-Equity does not constitute a waiver of the right to arbitration).

For this reason, and based on the remaining controlling authorities cited below in

the *Initial Brief of Appellants*, the joint motion should be properly adjudicated and a judicial decision rendered granting the motion and submitting the matter to mandatory mediation/arbitration.

**(E): The Defendants Have Not Defaulted Upon Nor Waived Their Right To Mediation/Arbitration Under The Mandatory Alternative Dispute Resolution Provisions Of The Contract And Applicable Law.**

**(1): The Master's Ruling That The Right To Arbitration Is An Affirmative Defense Which Has Been Waived By Appellants Constitutes An Error Of Law And Should Be Reversed.**

The Master, without citing any supporting authority, ruled in his October 28, 2016 order that "the affirmative defense of arbitration has been waived and Defendants' Motion to Stay and Compel filed July 11, 2016 was not properly made." The Respondent raised various arguments before the Master asserting that Appellants' right to arbitration under the arbitration agreement is an affirmative defense which has been waived by Appellants under both state and federal law.

**State Law Analysis**

The Respondent first claims that "arbitration" is an affirmative defense as *specifically defined* by Rule 8(c) SCRCP. However, neither the right to arbitration nor the existence of an arbitration agreement are listed as specific defenses under Rule 8(c) SCRCP. Instead, the only arbitration defense *specifically defined* in Rule 8(c) is the defense of "arbitration and award." The defense of "arbitration and award" is an affirmative defense asserting that the subject matter of the action has already been settled in arbitration. *Black's Law Dictionary* 120 (9th ed. 2009). Thus, the specified arbitration

defense contained in Rule 8(c) is limited to the situation where a dispute already have been arbitrated and an award has been obtained. *Id.* Neither of these events has occurred in this case and Respondent's reliance on Rule 8(c) is erroneous.

The Respondent next asserts that South Carolina courts have consistently held that arbitration is an affirmative defense. Respondent cites two South Carolina cases for this proposition; namely, *Bradley v. Brentwood Homes, Inc.,* 398 S.C. 447, 730 S.E. 2d 312 (2012) and *Partain v. Upstate Auto. Grp.,* 386 S.C. 488, 689 S.E. 2d (2010).

As a procedural matter, the defendant in the *Bradley* case asserted *lack of jurisdiction* due to an arbitration agreement as an affirmative defense in its responsive pleading. The defendant asserted its **right to arbitration in a motion to stay the proceedings and compel arbitration** filed concurrently with its responsive pleading. The plaintiff in the *Bradley* case initially opposed defendant's motion to compel arbitration on the ground that defendant waived the right to assert the *jurisdictional* affirmative defense due to defendant's delay in responding to discovery requests. Thus, the issue of whether, in South Carolina, the right to arbitration is an affirmative defense that is waived if not pled in a defendant's answer was not before the *Bradley* court. Furthermore, the *Bradley* court specifically stated that it did not need to address plaintiff's waiver argument *concerning delayed discovery* in light of its disposition on the merits.

Regarding the merits, the plaintiff claimed that the arbitration agreement in question was not subject to the Uniform Arbitration Act ("UAA") or the Federal Arbitration Act ("FAA"). In response, the defendant argued that even if the arbitration provision in the agreement did not comply with the requirements of the UAA, it was subject to the FAA as the transaction involved interstate commerce.

The *Bradley* court found that the arbitration agreement did not meet the requirements of the UAA and spent the remainder of its analysis on the legal issue of whether the transaction involved interstate commerce thus rendering the arbitration agreement enforceable under the FAA. The *Bradley* court ultimately held that the motion to stay the proceedings and compel arbitration must be denied due to a lack of sufficient evidence of interstate commerce.

In short, the *Bradley* court did not hold or otherwise rule that, in South Carolina, the right to compel arbitration is an affirmative defense that is waived if not pled by a defendant in a responsive pleading.

In the *Partain* case, the defendant asserted three affirmative defenses in its Answer, including an arbitration agreement with plaintiff. While a statement of fact as to the mechanics of defendant's answer and the defenses asserted therein, the *Partain* court's reference to these defenses in the procedural history of the case does not constitute a ruling that the right to arbitration is an affirmative defense that is waived if not pled under South Carolina law. In fact, the sole legal issue before the *Partain* court was whether the plaintiff's claims were within the scope of the arbitration agreement. Once again, the *Partain* court did not hold or otherwise rule as a matter of South Carolina law that the right to compel arbitration is an affirmative defense that is waived by a defendant if not pled in a responsive pleading.

The Respondent concluded its state law arguments before the Master with the assertion that an affirmative defense is waived if not pled in South Carolina. Respondent cites three South Carolina cases for this proposition. A review of these remaining three cases establish that they are distinguishable and inapposite to the arbitration issues before

this court.

The first case cited is *Delta Appparel, Inc. v. Farino,* 406 S.C. 257, 750 S.E. 2d 615 (Ct. App. 2013). The *Delta* case does not involve an arbitration agreement nor the issue of waiver of the right to arbitration. Also, the *Delta* case does not involve a situation wherein, as here, all parties to the litigation applied for arbitration via motions to stay and compel arbitration. Instead, the *Delta* case concerns the defenses of res judicata and collateral estoppel.

The second case cited is *Howard v. S.C. Dep't of Highways,* 343 S.C. 149, 538 S.E. 2d 291 (Ct. App. 2000). Likewise, the *Howard* case does not involve an arbitration agreement, the issue of waiver of the right to arbitration, nor the filing of applications for arbitration by all parties to the litigation. Instead, the *Howard* case concerns the defense of assumption of the risk.

The third and final case cited by Respondent is *RIM Assoc. v. Blackwell,* 359 S.C. 170, 597 S.E. 2d 152 (Ct. App. 2004). Once again, the *RIM Assoc.* case does not involve an arbitration agreement, the issue of waiver of the right to arbitration, nor the filing of applications for arbitration by all parties to the action. Instead, the *RIM Assocs.* case concerns the defense of res judicata.

On the other hand, contrary to the Respondent's arguments and cited cases, is the Court of Appeals opinion rendered in *General Equipment v. Keller Rigging,* 344 S.C. 553, 544 S.E. 2d 643 (Ct. App. 2001). In *General Equipment,* the defendants filed an answer denying the plaintiff's allegations, but did not include an affirmative defense of arbitration. Six months later, two weeks prior to the scheduled trial, the defendants filed a motion to compel arbitration. The Master denied defendant's motion to compel arbitration and the

defendants appealed. If, under South Carolina law, the defendants has waived their right to arbitration by failing to plead arbitration as an affirmative defense, the appellate court would have been bound to affirm the Master's denial of defendant's motion to compel arbitration. As a corollary, the appellate court would not have analyzed the traditional issues under South Carolina's established standard for waiver concerning the extent of the parties involvement in litigation, the period of delay and the undue burden and prejudice caused by that delay. Instead, the Court of Appeals applied the established South Carolina standard for waiver, held that the defendants had not waived their rights to arbitration and reversed the Master's decision.

Based on the above, as well as the remaining controlling authorities cited in the Initial Brief of Appellants, the Appellants have not waived their right to arbitration under South Carolina law.

**Federal Law Analysis**

The Respondent first claims that "arbitration" is an affirmative defense as *specifically defined* by Rule 8(c) FRCP. However, neither the right to arbitration nor the existence of an arbitration agreement are listed as specific affirmative defenses under Rule 8(c) FRCP. To the contrary, the only arbitration defense *specifically defined* in Rule 8(c) is the defense of "arbitration and award." The defense of "arbitration and award" is an affirmative defense asserting that the subject matter of the action has already been settled in arbitration. *Black's Law Dictionary* 120 (9th ed. 2009). Thus, the specified arbitration defense contained in Rule 8(c) is limited to the situation where a dispute already has been arbitrated and an award has been obtained. *Id.; Lee v. Grandcor Medical Systems, Inc.*, 702 F. Supp. 252 (D. Colo. 1988). Neither of these events have occurred in this case and

Respondent's reliance on Rule 8(c) is erroneous.

The Respondent next cites *McDonnell v. Dean Witter Reynolds, Inc.*, 620 F. Supp. 152 (D. Conn. 1985) for the proposition that under federal law arbitration is an affirmative defense that must appear in the answer and that "a party's failure to plead an affirmative defense bars its invocation at later stages of the litigation." *Id.*, 620 F.Supp. 152, 155-56.

The *McDonnell* case is an opinion issued by the United States District Court for the District of Connecticut. The District of Connecticut is not within the Fourth Circuit Court of Appeals; instead, it is located within the Second Circuit Court of Appeals. In the *McDonnell* case the plaintiff filed his federal action in April 1982. He filed claims against his securities broker, Dean Witter, Reynolds, Inc. ("Dean Witter") and a former Dean Witter employee for the alleged mismanagement of his securities account. Plaintiff filed his original and several amended complaints during the period between April 1982 and February 1983. Defendants filed a motion to dismiss and an answer during this 11 month period. The defendants' motion and answer failed to assert the right to arbitration.

Thereafter, for almost 2 years the parties engaged in lengthy discovery proceedings including interrogatories, depositions and production of documents. *Id.* On several occasions, the Court's intervention was necessary to resolve disputes which arose during the discovery process. *Id.*

Finally, in an effort to dispose of the case, the District Court ordered the parties to try the action in January 1985. *Id.* However, the case was continued to allow completion of discovery two times up until a trial date was set on April 4, 1985. *Id.*

Three days before jury selection, defendant Dean Witter *for the first time* sought by way of motion to compel arbitration of Plaintiff's state law claims. *Id.* On April 4, 1985,

defendant Dean Witter amended its motion to request arbitration of plaintiff's federal law claims as well. *Id.* On April 26, 1985, defendants moved to amend their answer to assert a "Sixth Affirmative Defense" for arbitration. *Id.* at 155. On May 2, 1985 defendants filed a "Clarified Motion to Compel Arbitration and for a Stay of Proceedings." *Id.*

The *McDonnell* court started its analysis by stating that arbitration is an affirmative defense that will be waived if not pled in a party's answer. *Id.* at 155. In making this statement, the *McDonnell* court was citing the standard applied in the United States Court of Appeals for the Second Circuit. The court was not citing the standard applied in the federal district courts in South Carolina and the Fourth Circuit Court of Appeals.

The *McDonnell* court next addressed the issue of whether the motion to amend the answer to assert the arbitration defense should be granted. The court determined that under the facts of the case it would be unfair and unjust to grant defendants' motion to amend. Specifically, the court held that: (a) granting the motion would cause prejudice and injustice to the plaintiff due to his engagement in comprehensive and expensive discovery, motion practice, and other proceedings preparatory to a trial in the court; (b) denying the motion would not be unjust or prejudicial to defendants since they would have a forum in this court to raise their defensed to plaintiff's claims and they had already expended substantial sums for discovery in this court, so that the only additional expense to defendants would be the expense of trial; and (c) the delay in seeking arbitration via the motion to amend was blatantly tardy, overwhelming and undue since the motion to amend was filed after the case was assigned for trial three times, and only three days before a jury was to be selected in this three-year old case. *Id.* at 156.

After issuing this ruling, the *McDonnell* court turned to the merits of the arbitration

waiver question and fully analyzed this issue *even though the defendants had not asserted arbitration as an affirmative defense in their pleading.* The court cited the following standards as the proper test by which to determine the question of waiver in cases pending in the Second Circuit: (1) whether the delay in the filing of a motion to compel arbitration prejudices the opposing party; or (2) whether there has been the litigation of substantial issues going to the merits by the time an intention to arbitrate was communicated by the defendant to the plaintiff. *Id.* at 159. Also, the court stated that the giving of notice of an intention to arbitrate to the party opposing arbitration was an important factor in Second Circuit cases as well. *Id.*

Applying these principles to the facts of the case, the *McDonnell* court stated "it is clear that Dean Witter has waived its right to arbitrate. Plaintiff, without notice that Dean Witter might move to compel arbitration, embarked on lengthy and expensive discovery and will be greatly prejudiced and inconvenienced by the delay. For its part, Dean Witer has engaged in robust pretrial litigation over a period of nearly three years, and *at no point raised the arbitration defense in an answer* ***or other filing.*** (emphasis added). In addition to moving for several extensions and attending chambers conferences, Dean Witter has engaged in discovery that would not have been available to it if it had gone to arbitration. The instant motion was filed only after this case was assigned and reassigned for trial. Under these circumstances, not only has Dean Witter's delay prejudiced plaintiff, but Dean Witter also has litigated "substantial issues going to the merits." *Sweater Bee,* 754 F. 2d at 461. Accordingly, under either of the standards set forth in *Sweater Bee* and *Caricich,* Dean Witter has waived its right to compel arbitration of this dispute." *McDonnell,* 620 F. Supp. At 159.

Turning to the present case, none of the Second Circuit factors considered dispositive by the *McDonnell* court are present. Specifically, in the present case: (1) there has been no substantial discovery or proceedings preparatory for trial in the lower court; (2) notice of the right to arbitration was timely inasmuch as Respondent itself moved to stay this action and compel arbitration contemporaneously with the commencement of litigation and Appellants joined in this motion and filed their own motion to stay and compel arbitration less than four (4) months thereafter; (3) while Appellants did not raise the arbitration defense in an answer, they did raise the defense early and often both in their Motion to Lift Entry of Default and Motion to Stay and Compel arbitration, and in their joinder in Respondent's Motion to Stay and Compel arbitration; (4) there has been no litigation whatsoever of substantial issues going to the merits; (5) there has been no prejudice to the Respondent associated with Appellants' application for arbitration; and (6) pursuant to the Master's orders below, the Appellants will be prejudiced since they will be restricted to a damages hearing and not have a forum in the court to raise their substantive defenses to Respondent's claims. Thus, under even the Second Circuit standard the Appellants have not waived their right to arbitration.

More importantly, under the proper and applicable standard applied by the federal district courts in South Carolina and the Fourth Circuit Court of Appeals, it is equally clear the Appellants have not waived their right to arbitration thereunder.

In *Patten Grading & Paving v. Skanska USA Building,* 380 F.3d 200 (4th Cir. 2004), the defendant appealed the denial of its motion to stay and compel arbitration under the Federal Arbitration Act ("FAA") by the United States District Court for the District of South Carolina. The defendant did not assert arbitration as an affirmative defense in a

responsive pleading. Instead, it filed a motion to stay and compel arbitration eight (8) months after the filing of plaintiff's complaint. Opposing defendant's motion, the plaintiff in *Patten Grading* asserted, as one of its grounds, the same claim as raised by the Respondent herein; namely, that the defendant's failure to raise arbitration as an affirmative defense constituted a waiver of its right to arbitration.

On that issue, the court stated "[a]lthough Patten does not formally make the following distinction, under Federal Rule of Civil Procedure 8(c), Skanska's failure to invoke the arbitration clause in its answer to Patten's complaint *arguably* (emphasis added) constitutes a waiver of that right, and thus an issue that is seemingly distinct from whether Skanska's participation in the litigation during the resulting delay in asserting that right amounts to a default under the FAA. However, it is well established that an affirmative defense is not waived absent unfair surprise or prejudice. *See, e.g., S. Wallace Edwards & Sons, Inc. v. Cincinnati Ins. Co.,* 353 F.3d 367, 373-74 (4th Cir. 2003). Because both rules require a showing of prejudice, we do not consider these to be distinct issues. *Cf. MicroStrategy,* 268 F.3d at 249 (noting "this principle of 'default' [in the FAA] is akin to waiver" (internal quotations omitted))." *Patten Grading,* 380 F. 3d at 209.

Rejecting the claim that defendant's failure to raise arbitration as an affirmative defense constituted a waiver, the *Patten Paving* court applied the established federal standard of waiver in the Fourth Circuit, ruled that the defendant had not waived its rights to arbitration and reversed the district court's decision. *Id.,* 300 F.2d 200.

The case of *Maxum Foundations, Inc. v. Salus Corp.,* 779 F.2d 974 (4th Cir. 1985) further illustrates the Fourth Circuit finding of non-waiver in cases where the defendant fails to plead arbitration as an affirmative defense. In *Maxum*, the appeals court held that

the defendant had not waived its right to arbitration when it did not raise arbitration as an affirmative defense in its answer, it delayed three (3) months after the complaint to file a motion to dismiss on the basis of the arbitration agreement, and it filed the motion to dismiss after discovery had been initiated in the action. *Id.*

Based on the above, as well as the remaining controlling authorities cited below in the *Initial Brief of Appellants*, the Appellants have not waived their right to arbitration under federal law.

**2. The Court Is Required To Apply The Proper Legal Standard To The Question Of Whether Appellants Waived Or Defaulted Upon Their Right to Mandatory Mediation/Arbitration.**

The parties' contract contains mandatory alternative dispute resolution provisions requiring the parties to mediate, and if necessary, arbitrate their disputes. The question before this court is whether the Appellants have waived or defaulted upon these rights based on the application of the proper legal standard to the facts of this case.

**State Law Standard**

The standards for establishing waiver of the right to arbitration are well established in South Carolina. *Carlson v. S.C. State Plastering, LLC*, 404 S.C. 250, 743 S.E. 2d 868 (Ct. App. 2013). In South Carolina, "[i]n order to establish waiver of the right to enforce an arbitration clause, a party must show prejudice through an undue burden caused by delay in demanding arbitration." *Liberty Builders, Inc. v. Horton*, 336 S.C. 658, 665, 521 S.E. 2d 749, 753 (Ct. App. 1999). "There is no set rule as to what constitutes a waiver of the right to arbitrate; the question depends on the facts of each case." *Id.* (internal quotation marks omitted).

The Court of Appeals has recognized three factors to consider when determining whether a party has waived its right to compel arbitration. These three factors are as follows: (1) whether a substantial length of time transpired between the commencement of the action and the commencement of the motion to compel arbitration; (2) whether the party requesting arbitration engaged in extensive discovery before moving to compel arbitration; and (3) whether the non-moving party was prejudiced by the delay in seeking arbitration. *Davis v. KB Home of S.C., Inc.*, 394 S.C. 116, 131, 713 S.E. 2d 799, 807 (Ct. App. 2011) (internal quotation marks omitted).

To establish prejudice, the non-moving party must show something more than mere inconvenience. *Id.* (internal quotation marks omitted). In addition to the above factors, the Court of Appeals has also considered the extent to which the parties have availed themselves of the circuit court's assistance. *See id.* at 133, 713 S.E. 2d at 808.

**Federal Law Standard**

The standards to determine waiver are equally well established in federal law jurisprudence. *Brown v. Green Tree Services, LLC*, 585 F. Supp. 2d 770 (D.S.C. 2008). Under federal law governing arbitration agreements subject to the Federal Arbitration Act, the party opposing arbitration bears a heavy burden of proving default or waiver. *Id.* Default or waiver only arises when the party seeking arbitration "so substantially utilize[ed] the litigation machinery that to subsequently permit arbitration would prejudice the party opposing the stay." *Patten Grading & Paving, Inc. v. Skanska USA Building, Inc.*, 380 F. 3d 200 (4th Cir. 2004); *see also, Brown v. Green Tree,* 585 F. Supp. 2d 770.; *Rich v. Walsh*, 357 S.C. 64, 590 S.E. 2d 506 (Ct. App. 2003). Because of the strong federal policy favoring arbitration the federal courts do not lightly infer the circumstances

constituting waiver. *Patten Grading*, 380 F. 3d 200.

**3. Applying The Proper Legal Standard To The Facts Of This Case Establishes Appellants Have Not Waived Nor Defaulted Upon Their Right To Mandatory Mediation/Arbitration.**

In the present case, the Appellants moved to set aside the entry of default, one of the grounds for which included Appellants' right to arbitration, within 2 ½ months after commencement of this action and within 1 ½ months after the entry of default. In addition, the Appellants filed their motion to compel arbitration less than four (4) months after commencement of the action, within 2 ½ months after the entry of default and within 5 weeks of learning of the entry of default.

Discovery has been extremely limited in this case. No depositions have been taken in this action. The Appellants have not served interrogatories, requests to produce nor any other form of written discovery. The Respondent has not responded to any interrogatories, requests to produce or any other form of written discovery. In fact, the only discovery to date is in the form of Appellants' answers to Respondent's basic First Set of Interrogatories and First Request for Production. This participation in discovery by Appellants was minimal and carried out pursuant to the direction of the Master. This minimal discovery does not constitute a waiver of Appellants' contractual right to arbitration. *See, Patten Grading,* 380 F. 3d at 206 (reciting precedent that the party seeking arbitration will not "lose its contractual right by prudently pursuing discovery in the face of a court-ordered deadline.").

The Master's assistance has been limited to: (a) 2 brief motions hearings concerning motions for a continuance of the damages hearing, to lift entry of default and to stay this

action and compel mediation/arbitration; and (b) 1 brief status conference to allow the proffer of information for the record on appeal and Respondent's alleged damages.

Finally, the Respondent has failed to show prejudice through an undue burden caused by the short delay in Appellants' demand for arbitration. The record contains no evidence which demonstrates prejudice to Respondent in this matter. *See, Initial Brief of Appellants, Section I (G).*

The proper legal standard is set forth in the *Initial Brief of Appellants, Section II (E) (2)* above. Applying the proper standard to the above-cited facts in this case, it is clear that the Appellants have not defaulted upon nor waived their right to mandatory mediation/arbitration under either state or federal law. *See Toler's Cove Homeowners Ass'n v. Trident Const. Co., Inc.*, 355 S.C. 605, 586 S.E. 2d 581; *Carlson v. South State Plastering, LLC*, 404 S.C. 250, 743 S.E. 2d 860 (Ct. App. 2013); *General Equip & Supply Co., Inc. v. Keller Rigging & Constr., SC, Inc.*, 344 S.C. 553, 544 S.E. 2d 643 (Ct. App. 2001); *Patten Grading & Paving, Inc. v. Skanska USA Building, Inc.*, 380 F. 3d 200 (4th Cir. 2004); *Brown v. Green Tree Services, LLC*, 585 F. Supp. 2d 770 (D.S.C. 2008); *Rich v. Walsh*, 357 S.C. 64, 590 S.E. 506 (Ct. App. 2003).

**4. The Entry Of Default Does Not Constitute A Default Or Waiver Of Appellants' Right To Mandatory Mediation/Arbitration.**

The Master, without citing any supporting authority, ruled in his July 14, 2016 order that "Defendants' motion to stay and to compel arbitration is denied as Defendant is in default." However, because there is no set rule as to what constitutes a waiver of the right to arbitrate, the entering of default alone cannot constitute a waiver of arbitration rights as a matter of law. *See Liberty Builders*, 336 S.C. 658, 521 S.E. 2d 749. Instead, all facts

must be considered and the question turns on the facts of each case. *Id.; see also Initial Brief of Appellants (and cases cited therein).*

The Respondent, however, argues that in the context of a litigant in default seeking to compel arbitration, unless the movant is able to show good cause for its default, the defaulting party has waived its right to assert arbitration against continued litigation in the circuit court. The Respondent cites one West Virginia case to support its proposition. The case cited by Respondent is *State ex rel. Barden & Robeson Corp. v. Hill,* 208 W. Va. 163, 539 S.E. 2d 106 (2000). This West Virginia case is distinguishable from the case at bar on numerous grounds.

The *Barden* case applies West Virginia law, not the controlling South Carolina law nor federal law from the District of South Carolina and the Fourth Circuit. While a default judgment was entered in the *Barden* case, the legal principles and foundation upon which this West Virginia case is based is entirely different than the case at bar. At the time of this decision, West Virginia **had not** enacted the Uniform Arbitration Act, and furthermore, had no codified codes or statutes that applied to the general application of arbitration to legal disputes. The West Virginia code made sporadic and cursory references to arbitration only in terms of specific situations.

South Carolina, on the other hand, is one of the majority of states that have enacted in one form or another the Uniform Arbitration Act. The Uniform Arbitration Act as adopted in South Carolina contains the following sections that clearly distinguish South Carolina from the West Virginia law applied in *Barden* in multiple critical areas:

S.C. Code §15-48-10(a) (2005) states in pertinent part: A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or equity for the revocation of any

contract.

S.C. Code §15-48-20(a) (2005) states in pertinent part: On application of a party showing an agreement described in §15-48-10, and the opposing party's refusal to arbitrate, the court **shall** order the parties to proceed with arbitration...(emphasis added.).

S.C. Code §15-48-20(c) (2005) states in pertinent part: If an issue referable to arbitration under the alleged agreement is involved in an action or proceeding pending in a court having jurisdiction to hear applications under subdivision (a) of this section, the application shall be made herein.

S.C. Code §15-48-20(d) (2005) states in pertinent part: Any action or proceeding involving an issue subject to arbitration shall be stayed if an order for arbitration or an application therefor has been made under this section...When the application is made in such action or proceeding, the order for arbitration shall include such stay.

S.C. Code §15-48-170 states in pertinent part: Except as otherwise provided, **an application to the court under this chapter shall be made by motion** and shall be heard in the manner and upon the notice provided by law or rule of court for the making and hearing of motions. (emphasis added.).

The above noted statutes clearly delineate that the standards and foundation upon which the South Carolina courts are working under the South Carolina Uniform Arbitration Act are wholly and substantially different than those employed by the West Virginia Court of Appeals in the *Barden* case.

A review of the Federal Arbitration Act ("FAA") statutes render the same result. The review below substitutes the word "Court" for any reference to the federal courts in the statutes in recognition of the South Carolina courts addressing FAA issues in cases before them involving interstate commerce.

9 U.S.C. §2 states in pertinent part: A written provision in a contract evidencing a transaction involving commerce to settle by arbitration a controversy hereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or equity for the revocation of the contract.

9 U.S.C. §3 states in pertinent part: If any suit or proceeding be brought [in Court]...upon any issue referable to arbitration under an agreement in writing for such

arbitration, the court in which suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, **shall on application of one of the parties** stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.
*See Patten Grading & Paving, Inc. v. Skanska USA Building, Inc.*, 380 F. 3d 200 (4th Cir. 2004) (noting the principle of default in the FAA is akin to waiver.).

9 U.S.C. §4 states in pertinent part: A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any [Court] which, save for such agreement, would have jurisdiction...in a civil action of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement...The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the [Court] in which the petition for an order directing such arbitration is filed.

9 U.S.C. §6 states: Any application to the court hereunder **shall be made and heard in the manner provided by law for the making and hearing of motions**, except as otherwise herein expressly provided. (emphasis added.).

Similar to South Carolina's Uniform Arbitration Act, the FAA employs a standard and foundation totally and significantly different than the West Virginia standard used in the *Barden* case.

Furthermore, while fully acknowledging that other courts find the arbitration defense in Rule 8(c) pertains exclusively to completed arbitration proceedings, the *Barden* court states that arbitration is an affirmative defense that *may, under appropriate circumstances, be deemed waived* if not pled under W. Va. R. Civ. P. 8(c). Thus, even under West Virginia law the failure to assert arbitration as an affirmative defense does not automatically constitute waiver. Instead, further *appropriate circumstances* are required, and even then, this *may be,* but is not required to be deemed a waiver.

However, the review of controlling South Carolina jurisprudence and federal court opinions from the Fourth Circuit contained in previous sections of the *Initial Brief of*

*Appellants* establishes that failure to raise a valid arbitration clause in initial and even subsequent court filings does not, in and of itself, nullify the existence of enforceability of the arbitration clause in these jurisdictions. Neither the South Carolina Uniform Arbitration Act nor the FAA requires arbitration to be pled as an affirmative defense or considers the right to arbitrate waived if the "defense" is not raised. In fact, these statutes make no reference to affirmative defenses. Instead, these acts expressly state that the proper method of application for arbitration shall be made by motion. *See* S.C. Code §15-48-10, et al (2005); 9 U.S.C. §§1-16.

Finally, the well-reasoned opinions of other jurisdictions employing waiver standards similar to the South Carolina state law standard and the District of South Carolina and Fourth Circuit federal standard are instructive on this issue in the context of default situations. For example, the case of *Cedar Surgery Center v. Bonelli,* 96 P. 3d 911, 2004 UT 58 (Utah 2004) applies the Utah standard of waiver of the right to arbitration. Utah shares the basic framework of South Carolina law and 4th Circuit federal law for deciding whether a party has waived a contractual right to arbitration.

The *Cedar* court framed the issue before it as whether defendants waived their contractual right to arbitration when they declined to participate in the underlying litigation and filed a motion to compel arbitration only after default judgement had been entered against them.

In the *Cedar* case, when the defendants failed to answer or file a responsive pleading to the complaint, the court entered a default judgment against them. When the defendants also failed to respond to the court's notice of a hearing to determine damages, the court entered a judgment for damages in the amount of $381,370 against the defendants.

Following the entry of judgment for damages, the defendants made their first appearance in the case by filing a Rule 60(b) motion for relief from default judgment and a motion to compel arbitration based on the arbitration clause in the parties' contract. In analyzing the defendants' motion, the *Cedar* court first stated the Utah standard for determining waiver.

The court stated that under Utah law, "for a court to find that a party has waived its arbitration right, the party alleging waiver must demonstrate: (1) that the party seeking arbitration substantially participated in the underlying litigation to a point inconsistent with the intent to arbitrate; and (2) that this participation resulted in prejudice to the opposing party." *Cedar,* 96 P. 3d 911, 914.

Applying this standard to the facts of the case the *Cedar* court stated that "[i]deally, the [defendants] would have raised the contractual arbitration clause in an answer to [plaintiff's] complaint and then brought a motion to compel arbitration, rather than simply ignoring the district court proceedings altogether. However, we do not find that such failure evidences an intent on the part of the [defendants] to waive their right to arbitration and pursue redress through litigation." *Id.,* 96 P 3d at 915.

Accordingly, the *Cedar* court found that the defendants' failure to participate in the underlying litigation and the entry of default judgment resulting therefrom **did not** constitute a waiver of their right to arbitration. *Id.* The *Cedar* court, therefore, held that the lower court did not abuse its discretion in setting aside the default judgment and compelling arbitration. *Id.*

Based on the above authorities, the entry of default against Appellants herein does not constitute a waive or default of Appellants' right to mandatory mediation/arbitration of

the parties' disputes. In light of the applicable and well established standards discussed throughout the *Initial Brief of Appellants*, the Court should reverse the Master's ruling, stay this action and compel the parties to mediate, and if necessary, arbitrate their disputes pursuant to their contractual agreement.

**(F): The Mandatory Requirements To Stay This Action And Submit The Matter To Mediation/Arbitration Shall Divest The Court of Subject Matter Jurisdiction**

The contract giving rise to this action requires mandatory mediation and, if necessary, binding arbitration. The Respondent acknowledged this fact and the mandatory nature of the alternative dispute resolution provisions at the inception of this litigation in its Motion to Stay and Compel. In fact, the Respondent made a formal demand for mandatory mediation/arbitration in its Motion to Stay and Compel filed with the Court.

Upon the filing of this motion, mandatory requirements of either the South Carolina Uniform Arbitration or the Federal Arbitration Act were triggered requiring the court to stay this action and submit the matter to mediation/arbitration. These same mandatory requirements were invoked a second time upon the Appellants joinder in Respondent's motion as well as the filing of their own Motion to Stay and Compel.

By virtue of the mandatory mediation/arbitration provisions in the contract, the applications of all parties for mediation/arbitration and the triggering effect of those applications upon the mandatory requirements to stay and compel arbitration under both the state and federal arbitration statutes, the Court is required to stay this litigation and submit the matter to mediation/arbitration. This stay of litigation requirement is mandatory under both federal and South Carolina law. *U.S. ex rel. Coastal Roofing Co., Inc. v. P. Browne & Associates, Inc.*, 585 F. Supp. 2d 708 (D.S.C.); *Widener v. Fort Mill Ford*, 381

S.C. 522, 674 S.C. 172 (Ct. App. 2009).

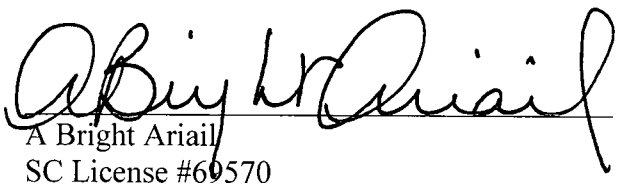
Under both federal and South Carolina law, when a case is sent to arbitration, the court is divested of jurisdiction over the case. *Id.*; *Main Corp. v. Black*, 357 S.C. 179, 592 S.E. 2d 300 (2004). By virtue of the requirements of a mandatory stay and submission to mandatory mediation/arbitration, the Court shall be divested of jurisdiction over the matter.

## CONCLUSION

For the reasons stated above, this Court should reverse the rulings of the circuit court, lift the entry of default, stay this action and compel mandatory mediation/arbitration pursuant to the contractual agreement of the parties.

Respectfully submitted,

LAW OFFICE OF A. BRIGHT ARIAIL, LLC



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