IN THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM CHARLESTON COUNTY
Court of Common Pleas
The Honorable Mikell R. Scarborough, Master in Equity

2016-CP-10-1143
Appellate Case No.: 2016-002308

Palmetto Construction Group, LLC Respondent,

v.

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

FINAL BRIEF OF RESPONDENT

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4. Whether the Master in Equity acted within his discretion in denying Appellants motion to be relieved from default?

II. STATEMENT OF THE CASE

This matter arises out of Respondent Palmetto Construction Group, LLC's ("PCG's") complaint against Appellants alleging, *inter alia*, that Appellants misappropriated funds from a construction project for the Department of Veterans' Affairs ("VA"), failed to pay its subcontractors and suppliers, and defaulted on its agreements with PCG and the surety, Hanover Insurance Company ("Hanover"), leaving PCG responsible to its subcontractors and the surety for in excess of $1.4 Million. Appellants were personally served with the summons and complaint, but failed to respond. Appellants were held in default and the matter was referred to the Master in Equity.

The day before the damages hearing, counsel appeared on behalf of the Appellants, seeking a continuance of the damages hearing and relief from the default judgment. Appellants later filed a motion to compel arbitration. After two hearings on the motions, the Master in Equity issued an order denying Appellants' motion to lift the default and finding that the arbitration motion was not properly before him as the Appellants were in default. (ROA 4). The Master succinctly stated his ruling at the hearing: "Well, Ms. Ariail,

I think the first thing you have to do is get out of default before you can bring affirmative relief." (ROA 467, at 9:2-4). Appellants filed a motion to reconsider, which was denied after a third hearing. Appeals followed; Appellants first appeal was denied by this Court. (ROA 7).

No final judgment has been entered as this appeal was filed before the damages hearing was held.

III. STATEMENT OF THE FACTS

A. The Project

Appellant Restoration Specialists, LLC ("Restoration Specialists") was awarded a contract with the VA for completion of a parking garage for the VA facility in Augusta, Georgia (the "VA Project"). The contract between Restoration Specialists and the VA is dated March 29, 2012 (ROA 577), though the project was delayed for several years before commencement. The total contract price was ultimately in excess of $8.1 Million. (ROA 574–76). Restoration Specialists was the general contractor on the VA Project, responsible for hiring subcontractors and obtaining a payment and performance bond. Appellant R. Mark Ward is the owner of Restoration Specialists. Appellant Lynnette Pennington Ward is his wife. Restoration Specialists is a Georgia company.

In November of 2011, Restoration Specialists entered into a Teaming Agreement with Appellant PCG. (ROA 1697). PCG is a South Carolina company with a specialty in concrete work. The Teaming Agreement contemplated that Restoration Specialists and PCG would work together on multiple construction projects; Restoration Specialists and PCG did successfully complete some projects without incident prior to the VA Project. Mr. Ward of Restoration Specialists approached PCG about working on the VA project as

a concrete subcontractor, as well as in a supervisory capacity. Further, Mr. Ward indicated that Restoration Specialists was unable to secure the sizable bond the VA Project required, and asked that PCG obtain the bond from its surety, Hanover. PCG agreed and a subcontract was entered into between Restoration Specialists and PCG dated September 10, 2014. (ROA 1703). Pursuant to the subcontract agreement between Restoration Specialists and PCG, Restoration Specialists would remain the general contractor on the VA Project and would hire all subcontractors, and PCG would perform concrete work and work in a supervisory capacity as well as aid Restoration Specialists in obtaining the bond. Pursuant to the subcontract, PCG was to be paid as a concrete subcontractor for its work and was also to share the profits equally with Restoration Specialists. (ROA 1718).

PCG's surety, Hanover, did issue the payment and performance bond for the project, Bond No. 9000-0045. (ROA 1729). However, Hanover required that both PCG and Restoration Specialists, as well as their respective principals and their spouses sign an indemnity agreement, requiring them to indemnify Hanover for any sums it expends in paying claims made on the bond. (ROA 1719).

The concrete work was performed by PCG, and as the Project neared completion, PCG asked that the parties meet to discuss the profit split provided for in the subcontract. (*See* ROA 1733). However, at this time PCG was alerted that several of Restoration Specialists' subcontractors had not received payment. PCG too, was owed over $180,000.00 pursuant to its own subcontract with Restoration Specialists. *Id.* PCG approached Mr. Ward several times about these issues but received no answer. It soon became apparent that multiple subcontractors were owed money, which Hanover was required to pay, in the amount of $1,425,144.00. (ROA 1778). Hanover in turn made a

demand under its indemnity agreement and upon the VA for the contract balance but by this time Mr. Ward had collected all but $90,000 of the $8.1 Million contract. *See* ROA 574–76.

B. PCG's Complaint

PCG filed its summons and complaint against the Appellants on February 12, 2016. PCG's complaint alleges a breach of contract action against Appellant Restoration Specialists for its failure to pay PCG the funds due pursuant to the subcontract between Restoration Specialists and PCG. PCG sued all Appellants for actual and constructive fraud and negligent misrepresentation regarding the Appellants' misappropriation of funds paid to them by the VA, which resulted in over $1.4 Million in claims by subcontractors on the payment bond. PCG also filed a motion to stay and compel arbitration as the subcontract between PCG and Restoration Specialists contains an arbitration provision.

PCG personally served its summons and complaint together with a motion to compel arbitration on Appellants on March 14, 2016. (ROA 66, 68, 70). When the Appellants failed to answer or otherwise respond, an affidavit of default was filed on April 18, 2016. (ROA 64). Because of the default, PCG withdrew its motion to stay and compel arbitration and on April 21, 2016 referred the matter to the Master in Equity for determination of damages. (ROA 3).

C. The Master in Equity's July 14, 2016 Order

A damages hearing was scheduled by the Master for June 6, 2016. The day before the hearing, counsel appeared on behalf of Appellants and filed a motion for continuance and a motion to be relieved from default. (ROA 77, 82). No motion or request was made then by Appellants to invoke the arbitration provision. The parties appeared before the

Court on June 6, 2016, and Appellants submitted an affidavit of R. Mark Ward in support of the Appellants' motion to be relieved from default (ROA 74). The Appellants did not raise the issue of arbitration at this hearing or by affidavit. The Court granted Appellants' motion for a continuance of the damages hearing and held Appellants' motion to lift the default in abeyance to allow the parties time to exchange financials in advance of a damages hearing.

However, the Court did note:

> Your Motion for Relief from the Entry of Default - I'm not going to rule on yet. There's not much I saw in that affidavit that would give me indication that I would grant that motion. I can tell you that right now. Okay?

(ROA 466, at 11:20-24). Appellants provided answers to PCG's interrogatories and requests for production on July 7, 2016. (ROA 534). Appellants then made three separate document productions on July 6, 11, and 13, 2016 consisting largely of financial records related to the project.

On July 11, 2016, Appellants filed a motion to compel arbitration. On July 14, 2016, the Master issued his order. (ROA 4). A damages hearing was set for October 4, 2016 at 2:00pm. *Id.*

D. The Initial Appeal

On September 30, 2016, PCG was served with a notice of appeal, and immediately moved to dismiss the appeal. On October 5, 2016, PCG's counsel received a letter from the Court of Appeals returning its motion to dismiss on the grounds that the Court had no record of such an appeal being filed. (ROA 533). Also on October 5, PCG was served by facsimile with a copy of another notice of appeal, different than the one previously served, which attached the July 14, 2016 Order and portions of the transcript of the hearing. On

October 6, 2016, PCG's counsel was served by facsimile with yet another version of the notice of appeal. On October 17, 2016, PCG's counsel received a letter from the Court of Appeals stating that one of the notices of appeal was being returned to Ms. Ariail together with the transcript as the transcript was not an order and was not properly included with a notice of appeal. (ROA 1783). The Court had filed the first appeal which was served on Respondents on September 30, 2016. PCG promptly refiled its motion to dismiss the appeal which was granted by this Court on November 10, 2016. (ROA 7).

E. Appellants' Motion to Reconsider

Appellants' filed a motion to reconsider pursuant to Rule 59 SCRCP on July 27, 2016. (ROA 125). The motion to reconsider was scheduled to be heard by the Master on October 11, 2016. Appellants wrote the court on September 7, asking that the motions to reconsider be heard in advance of the damages hearing. This request was denied. The parties appeared before the Master for the damages hearing on October 4, 2016. The Master, believing an appeal had been filed by Appellants, elected not to proceed with the damages hearing but requested a damage proffer and heard argument on Appellants' motion to reconsider. The motion was denied on the grounds that: (1) Appellants failed to show good cause to lift the default; and (2) the Appellants' motion to stay and compel arbitration was not properly made as a party in default cannot seek affirmative relief. (ROA 5).

F. The Appeal *Sub Judice*

This appeal followed the Master's denial of Appellants' motion to reconsider.

IV. SUMMARY OF ARGUMENT

This is the second interlocutory appeal (though the fifth notice of appeal) filed by Appellants in this case. The first appeal was dismissed by this Court on November 10, 2016. (ROA 7). Appellants are in default and appealed before a damages hearing was held or a default judgment was entered. In order to prevent the damages hearing from moving forward, the Appellants appealed, though it is undisputed that two of the Appellants—Mark and Lynnette Ward—are not parties to any contract containing an arbitration provision and this is an interlocutory appeal from an order refusing to lift the entry of default. This Court should dismiss this interlocutory appeal and remand to the Master for a damages hearing and an entry of final judgment. Should this Court render a decision, the Master should be affirmed as:

1) The Master did not abuse his discretion in refusing to lift the default as Appellants failed to provide good cause, lack a meritorious defense, and Respondent PCG has been prejudiced by their conduct;

2) The Master correctly held that Appellants' motion to stay and compel arbitration was not properly before him as: (a) arbitration is an affirmative defense pursuant to both federal and SC law; (b) affirmative defenses are waived if not pled; (c) a party who goes into default waives the right to demand arbitration; and (d) Appellants in this case have taken actions inconsistent with arbitration, including participating in discovery, filing motions and affidavits, and appearing at hearings without raising the arbitration provision.

V. ARGUMENT

A. The Appeal Must Be Dismissed in Its Entirety

The Appeal must be dismissed as both orders appealed from are interlocutory.

Appellants appeal the Master's Order dated July 14, 2016, which denies Appellants' motion to lift the entry of default against them as well as the Master's Order dated October 28, 2016, denying Appellants' motion to reconsider. "An order denying a motion to lift entry of default is interlocutory and not immediately appealable." *See Thynes v. Lloyd*, 294 S.C. 152, 153, 363 S.E.2d 122, 122 (Ct. App. 1987) ("an order refusing to grant relief from the entry of default is not appealable until after final judgment"). Appellants contend that the orders are appealable because they also deny that the dispute is subject to arbitration. However, the Orders make no substantive ruling on the arbitration issue and thus are not immediately appealable. Rather, Judge Scarborough held that the arbitration motion was not properly before him as the Appellants were in default. *See* ROA 4. Judge Scarborough succinctly stated his ruling at the July 14, 2016 hearing: "Well, Ms. Ariail, I think the first thing you have to do is get out of default before you can bring affirmative relief." (ROA 467, at 9:2–4). At the hearing on Appellants' motion to reconsider, Judge Scarborough reasoned:

> The question as I see it is whether or not the question for the appeal is procedural, whether or not there's a final order from which you can appeal. I think that's number one. The second thing has to do with whether or not there's finality to that, and I don't think there's finality until a determination of damages has been held.

(ROA 475, at 32:15-21). The Master's conclusion is in keeping with well-established precedent that "[a]n order denying a motion to lift entry of default is interlocutory and not immediately appealable." *Thynes*, 294 S.C. at 153, 363 S.E.2d at 122.

A motion to reconsider an order denying relief from default is no more appealable than the original order denying relief from default. *Id.*

1. Appellants' motion to reconsider was not properly before the Master.

What follows is a nuance but one that should disturb this Court. While this appeal in its entirety should be dismissed, this Court cannot review the Master's order denying the Motion to Reconsider as the Master had no jurisdiction to enter that order as jurisdiction was vested in the Appellate Court by virtue of Appellants' notices of appeal.

"[S]ervice of notice of an intent to appeal divests the lower court of jurisdiction," *Jackson v. Speed*, 326 S.C. 289, 311, 486 S.E.2d 750, 761 (1997), though the lower court may typically consider a timely post-trial motion notwithstanding the filing of an appeal. *Shumpert v. Time Ins. Co.*, 329 S.C. 605, 616 n. 5, 496 S.E.2d 653, 658 (Ct. App. 1998). However, the circumstances of this case are not typical.

On the morning of the damages hearing, October 4, 2016, Appellants urged the Master that he could not proceed because of an appeal served on September 30, 2016. The Appellants intended and succeeded in delaying the damages hearing because of the service of a notice of appeal that divested the Master of jurisdiction. This is not a case of simultaneous or near simultaneous filing of a Motion to Reconsider and delay of the damages hearing; rather Appellants intended to vest jurisdiction in the Appellate Court. Like residency which is a state of mind, Appellants intended the appeal and subsequent appeal to divest the Master of jurisdiction so he could not rule on damages. The Master's subsequent order denying the Motion to Reconsider was without jurisdiction.

True, the result is the same; a remand as this appeal is interlocutory, but here is an unmasking of the use of process in a way never intended. Respondents have suffered from Appellants' misuse of process and actions ask this Court to say so.

B. The Appeal of Mark and Lynnette Ward must be Dismissed

1. Appellants Mark and Lynnette Ward concede they have no arbitration provision.

There are multiple Appellants/Defendants named in this action, and all are in default. Arbitration is not a defense available to Mark Ward or Lynette Ward for an additional reason as they concede they are not parties to the construction contract that contains the arbitration provision. *See Simpson v. MSA of Myrtle Beach, Inc.*, 373 S.C. 14, 644 S.E.2d 663, 62 U.C.C. Rep. Serv. 2d 217 (2007) (arbitration is available only when the parties involved contractually agreed to arbitrate). The subcontract containing the arbitration provision is between Restoration Specialists and PCG. Mark and Lynette Ward have no arbitration provision. The appeal, as to these parties, must be dismissed.

2. PCG's claims against Mark and Lynnete Ware are not "intertwined" or "interwoven" with the concrete work subcontract that contains the arbitration provision.

Appellants alleged that, though Mark and Lynnette Ward are not parties to any contract containing an arbitration provision, the claims PCG makes against them are "intertwined" with the agreement that contains the arbitration provision — the subcontract between PCG and Restoration Specialists. Appellants rely on a District Court decision styled *U.S. ex rel. Coastal Roofing Co., Inc. v. P. Browne & Associates, Inc.*, 585 F. Supp. 2d 708 (D.S.C. 2007). The District Court articulated the intertwined claims test as follows:

> 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. at 714 (citation omitted). The District Court further explained:

> [T]he signatory need not necessarily assert a cause of action against the nonsignatory for breach of the contract containing the arbitration clause.

> 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."

Id. at 715 (citation omitted). The test is similar to that articulated by the South Carolina Court of Appeals in *Chassereau v. Global-Sun Pools, Inc.*, 363 S.C. 628, 611 S.E.2d 305 (Ct. App. 2005), *aff'd*, 373 S.C. 168, 644 S.E.2d 718 (2007) to determine whether a tort claim is subject to arbitration:

> The test is based on a determination whether the particular tort claim is so interwoven with the contract that it could not stand alone. If the tort and contract claims are so interwoven, both are arbitrable. On the other hand, if the tort claim is completely independent of the contract and could be maintained without reference to the contract, the tort claim is not arbitrable.

Id. Under either test, the facts show that PCG's claims against Mark and Lynette Ward are not intertwined or interwoven with the subcontract between Restoration Specialists and PCG. PCG's complaint alleges a breach of contract action against Appellant Restoration Specialists for its failure to pay PCG the funds due pursuant to the subcontract between Restoration Specialists and PCG. This cause of action would be subject to arbitration, which is why PCG filed its motion to stay and compel arbitration with its complaint. *See* ROA 9–41, 42–60. However, PCG withdrew the motion upon Appellants' default (*see infra*) and, for the reasons articulated below, believes all arbitration rights have been waived.

PCG also sued for actual and constructive fraud and negligent misrepresentation regarding the Appellants' misappropriation of funds paid to them by the VA, which resulted in over $1.4 Million in claims by subcontractors on the payment bond and a demand for indemnity from Hanover pursuant to the indemnity agreement. (ROA 14). PCG sought equitable and injunctive relief and an accounting concerning the same. (ROA

15). The foregoing claims have absolutely nothing to do with the subcontract for concrete work that contains the arbitration provision; PCG's claim against Restoration Specialists for breach of this agreement is based on the fact that PCG has not been paid in full for their work. On the other hand, PCG's other claims against arises out of the bond and indemnity agreement with the surety, Hanover. Turning to the intertwined claims test, there is nothing in the claims for fraud, negligent misrepresentation, breach of the indemnity agreement, or the equitable relief sought by PCG that arises out of duties or obligations in the subcontract. There is no requirement that PCG provide a payment bond for the project in the subcontract. There is no requirement that PCG provide indemnity to the surety in the subcontract. There is no requirement in PCG's subcontract with Restoration Specialists that Restoration Specialists pay its other subcontractors. The subcontract between Restoration Specialists and PCG is a simple form contract for PCG's provision of concrete work. *See* ROA 1703. The other claims arise out of the indemnity agreement and the bond — neither of which contains an arbitration provision. *See* ROA 1729–31 (Bond), 1719 (Indemnity Agreement). These claims are completely independent of the subcontract and all of them survive without reference to it. The doctrine of intertwined or interwoven claims is not applicable. Accordingly, the appeal of Lynette and Mark Ward must be dismissed.

C. The Master Properly Denied Defendants' Motion to Be Relieved from Default

1. The Master did not abuse his discretion.

The South Carolina Rules of Civil Procedure provide: "For good cause shown the court may set aside an entry of default . . . ." Rule 55(c), SCRCP. "The decision of whether to grant relief from an entry of default is solely within the sound discretion of the trial

court." *Wham v. Shearson Lehman Bros., Inc.*, 298 S.C. 462, 465, 381 S.E.2d 499, 501 (Ct. App. 1989). In the present case, the Court correctly concluded that the Defendants failed to show good cause for why the default should be lifted.

Appellants submitted an affidavit by Mr. Ward, acknowledging service of the complaint but stating that he failed to answer because he believed this litigation was part and parcel of that filed by Hanover, the surety. First, there is no litigation filed by Hanover. Second, even if Mr. Ward believed what he stated under oath, this does not explain why Appellants would ignore a summons and complaint. Further, the Master did not abuse his discretion in finding Appellants do not have a meritorious defense to Plaintiff's claims as Mr. Ward *acknowledges* that he has failed to pay his subcontractors and suppliers, despite being paid over $8 Million dollars by the Department of Veterans Affairs. *See* ROA 574–76 (final pay application signed by Ward), ROA 74 (affidavit of Mark Ward).

2. Appellants do not have a meritorious defense.

a. The Arbitration Provision as a meritorious defense

Appellants claim the arbitration provision is a meritorious defense. *See* Appellants' Brief at 18–19. However, the U.S. Supreme Court has held that an arbitration provision is not a substantive or contractual defense to an action's merits. *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628, 105 S. Ct. 3346, 87 L.Ed.2d 444 (1985) (agreeing to arbitrate a claim does not forgo or convey substantive rights but merely submits their resolution to an arbitral, not judicial, forum).

The remainder of Appellants' examples of their alleged meritorious defenses are belied by their own records.

b. Appellants' assertion that PCG was overpaid

Appellants claim as a defense that PCG has been over paid $14,000 under its subcontract.[1] There is no basis to support this allegation, and in fact, the records, including those provided by Restoration Specialists in discovery, show that PCG is owed $184,858.69. *See* ROA 1627–40 (Checks to PCG written by Restoration Specialists), ROA 1775–76 (Subcontract Pay Application Breakdown), ROA 1762–74 (Job Cost Billing Detail), ROA 1703–18 (PCG-Restoration Specialists Subcontract), ROA 1760–61 (AR history report).

c. Profit Sharing

Appellants next claimed that there is no profit-sharing provision in the Teaming Agreement.[2] Appellants cite the Teaming Agreement which states: "[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." Appellants' Brief at 19 (emphasis added). The teaming agreement specifically contemplates profit sharing being provided for in subsequent agreements, which is exactly what happened with the VA Project. Despite Appellants claim that there is "nothing in the Subcontract Agreement" that allows for profit sharing (Appellants Brief at 19), there is just such a provision. The profit-sharing provision is found in the parties' agreement, which delineates all sums that Restoration Specialists is to pay PCG, including the "RS/PCG Projected 50% Profit Share." *See* ROA 1718 (PCG Subcontract Breakdown, made part of the Subcontract by way of Subcontract Provision

[1] Appellants argue a set-off, which is properly the subject of the damages hearing.

[2] *See supra* n. 1.

16.1.4.2 titled "Other documents" (ROA 1717), which reads: "[l]ist here any additional documents that are intended to form part of the Subcontract Documents...#1. PCG Subcontract Breakdown"). Appellants' assertion that there is no profit-sharing agreement between PCG and Restoration Specialists is belied by the parties' written agreement.

d. The Merit of the Subcontractors' Claims

Appellants next claim as a meritorious defense that they dispute many of the claims made by the subcontractors that have made claims against the payment bond, essentially arguing that Hanover has overpaid the bond claimants.[3] First, this is not a defense to PCG's claim. However, in its most recent demand letter to all indemnitors, Hanover states:

> Hanover conducted its own investigation of the claims pursuant to the Miller Act, 40 U.S.C.S. § 270a et seq., and has sought your input in the payment of these claims including whether any viable defenses to the claims exist, and has made payment to the bond claimants and secured releases of the claims.

(ROA 1778) (emphasis added). As of the date of Hanover's demand, Appellants had no defenses to the subcontractors' claims, which is why they were paid by Hanover. For example, Mr. Ward's email exchanges with Hanover show that after several attempts by Hanover to obtain information from Mr. Ward regarding the bond claim made by a subcontractor of Restoration Specialists' called Tupperway, Hanover finally asked Mr. Ward, "So I should just pay them?" and Mr. Ward responded, "Certainly not what I want but I don't think we can win this argument." (ROA 1734).

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[3] *See supra* n. 1.

e. Appellants assertion that Restoration Specialists has not been paid by the VA

For purposes of this next claimed meritorious defense, Appellants concede that Restoration Specialists "has not paid all subcontractors and vendors in full" but alleges the lack of payment is due to the "VA having not yet made its final payment" to Restoration Specialists. Appellants' Brief at 20. Appellants' records and answers to interrogatories establish that the VA is holding approximately $90,887.08 in retainage, and this because the VA received notice of subcontractor claims. (ROA 543–44). However, Appellants can hardly claim that the lack of a $90,887.08 payment has resulted in sixteen of Restoration Specialists' subcontractors making $1,425,144.00 in claims on the payment bond. (ROA 1778–79). Further, the documents provided by Appellants in discovery also show that Restoration Specialists received over $8.1 Million from the VA. This sum, based solely on the contract with the VA and the subcontracted cost ($6,929,212.00 per Appellants) and in house cost ($1,038,724.04 per Appellants) provided by Appellants in discovery, should have been more than enough to pay all the subcontractors in full and produce a profit of $226,092.67.[4] *See* ROA 577 (Notice of Award), ROA 1754–56 (Restoration Specialists' contract log), ROA 1757–58 (Restoration Specialists' monthly expenses spreadsheet).

f. Waiver of Consequential Loss

The final defense alleged by Appellants in their brief concerns a waiver of indirect, special, or consequential losses, found in Article 9 of the Teaming Agreement. PCG is

[4] The profit of $226,092.67 is based solely on the figures provided by Appellants. When the inflated in house costs is adjusted per industry standards to $642,385.80, and the subcontract cost is adjusted up in favor of Appellants to $7,108,182.00 (based on an error in Restoration Specialists' subcontract log), the VA Project produced a profit of $443,460.91. *See* ROA 1753.

claiming damages arising out of Restoration Specialists' breach of its subcontract with PCG, including the $184,858.69 that PCG is still owed for its concrete work and $221,730.46 for the agreed upon 50/50 profit split. PCG is further claiming the $1,425,144.00 that has been demanded of PCG by Hanover as a result of Appellants' breach of the indemnity agreement and misappropriation of funds from the VA Project. These are contract damages and not consequential losses.

3. PCG has been Prejudiced.

Appellants never sought to advance their arbitration claim, rather they sought to lift the default and engaged in discovery, thus using the judicial machinery. Appellants only advanced the arbitration provision when faced with the denial of their motion to lift default. Appellants' efforts were calculated to delay by tying this matter up in appeals. The net result is PCG (and its owners as indemnitors) face bankruptcy. Further, PCG has taken actions, like the withdrawal of its own motion to compel arbitration and referral of the action to the Master in Equity, because of the Appellants' default. If Appellants had properly responded to PCG's summons and complaint and Restoration Specialists had consented to PCG's motion to arbitrate those claims arising out of the subcontract that are subject to arbitration, the arbitration of the subcontract claims could have already been completed and the litigation concerning the bond claims and demand by Hanover could be well under way. Instead, PCG has now incurred attorneys' fees in litigation with the Appellants for over a year, taking place in the circuit court, before the Master in Equity, and in the Court of Appeals, including one appeal that has already been dismissed by this Court. *See* ROA 7.

D. The Lower Court Correctly Held That the Motion to Compel Arbitration Was Not Properly Before Him as Parties in Default Cannot Seek Affirmative Relief

1. Arbitration Is an Affirmative Defense.

The policy of the United States and South Carolina is to favor arbitration of disputes. *Vestry and Church Wardens of Church of Holy Cross v. Orkin Exterminating Co., Inc.*, 356 S.C. 202, 588 S.E.2d 136 (Ct. App. 2003). Nevertheless, a circuit court's factual findings will not be reversed on appeal if there is any evidence reasonably supporting the findings. *McMillan v. Gold Kist, Inc.*, 353 S.C. 353, 577 S.E.2d 482 (Ct. App. 2003).

Rule 8(c), SCRCP states in relevant part:

> Affirmative Defenses; Reply. In pleading to a preceding pleading, a party shall set forth affirmatively the defenses: accord and satisfaction, arbitration and award, assumption of risk, condonation, contributory negligence, discharge in bankruptcy, duress, fraud, illegality...and any other matter constituting an avoidance or affirmative defense.

South Carolina courts have consistently held that arbitration is an affirmative defense. *See, e.g., Bradley v. Brentwood Homes, Inc.*, 398 S.C. 447, 452, 730 S.E.2d 312, 314 (2012) (where plaintiff "opposed the motion to compel arbitration on the ground Brentwood Homes waived the right to assert the affirmative defense due to its delay in responding"); *Partain v. Upstate Auto. Grp.*, 386 S.C. 488, 490, 689 S.E.2d 602, 603 (2010) ("Upstate Auto asserted three affirmative defenses in its Answer, including an arbitration agreement with Partain.").

The law is the same if the FAA applies. Where the contract documents "evidence transactions in commerce," the FAA, enacted pursuant to the commerce clause, supersedes South Carolina law. *Episcopal Hous. Corp. v. Fed. Ins. Co.*, 269 S.C. 631, 640, 239 S.E.2d

647, 652 (1977). Ms. Ariail represented that Restoration Specialists is a Georgia corporation, and the project was in fact constructed in Augusta Georgia. Therefore, there is interstate commerce and the FAA applies. The analysis under the FAA is the same as under the South Carolina Rules of Civil Procedure as arbitration is an affirmative defense under Rule 8(c) of the Federal Rules of Civil Procedure. *See, e.g., McDonnell v. Dean Witter Reynolds, Inc.*, 620 F. Supp. 152, 155-56 (D. Conn. 1985) (holding that under Fed. R. Civ. P. 8(c), the affirmative defense of arbitration must appear in the answer); *see also Gen. Star Nat'l Ins. Co. v. Administratia Asigurarilor de Stat*, 289 F.3d 434, 438 (6th Cir. 2002) (finding waiver where a movant waited until after the entry of default judgment to compel arbitration). Further, as the 6th Circuit held:

> Regardless of whether a defendant is required to raise arbitration as a defense under Rule 8(c), a defendant's failure to raise arbitration as an affirmative defense shows his intent to litigate rather than arbitrate. The filing of an answer is, after all, the main opportunity for a defendant to give notice of potentially dispositive issues to the plaintiff; and the intent to invoke an arbitration provision is just such an issue.

Johnson Associates Corp. v. HL Operating Corp., 680 F.3d 713, 718 (6th Cir. 2012).

2. An Affirmative Defense is Waived if Not Pled.

An affirmative defense is waived if not pled. *Delta Apparel, Inc. v. Farina*, 406 S.C. 257, 272, 750 S.E.2d 615, 623 (Ct. App. 2013) (internal citations omitted); *Howard v. S. C. Dep't of Highways*, 343 S.C. 149, 152, 538 S.E.2d 291, 294 (Ct. App. 2000); *see also RIM Assocs. v. Blackwell*, 359 S.C. 170, 182-83, 597 S.E.2d 152, 159 (Ct. App. 2004) (claims or defenses not presented in the pleadings are waived). Under Fed. R. Civ. P. 8(c), the affirmative defense of arbitration must appear in the answer, and "a party's failure to plead an affirmative defense bars its invocation at later stages of the litigation." *McDonnell v. Dean Witter Reynolds, Inc.*, 620 F. Supp. 152, 155-56 (D. Conn. 1985) (citing *Doubleday*

& Company, Inc. v. Curtis, 763 F.2d 495, 503 (2d Cir. 1985)); *see also Gen. Star Nat'l Ins. Co. v. Administratia Asigurarilor de Stat*, 289 F.3d 434, 438 (6th Cir. 2002) (finding waiver where a movant waited until after the entry of default judgment to compel arbitration).

3. Waiver by way of Default

In the context of a party in default seeking to compel arbitration, courts in the 4th Circuit and across the country have held that unless the movant can show good cause for its default, the defaulting party has waived its right to assert arbitration as an affirmative defense against continued litigation in the circuit court. *See State ex rel. Barden & Robeson Corp. v. Hill*, 208 W. Va. 163, 168-69, 539 S.E.2d 106, 111–12 (2000) (citing *Am. Recovery Corp. v. Computerized Thermal Imaging, Inc.*, 96 F.3d 88, 96 (4th Cir. 1996) (affirmative defense of arbitration must be pled in answer)); *McDonnell v. Dean Witter Reynolds*, Inc., 620 F. Supp. 152, 155-56 (D. Conn. 1985) ("the affirmative defense of arbitration must appear in the answer, and 'a party's failure to plead an affirmative defense bars its invocation at later stages of the litigation'"(internal citation omitted)). In *State ex rel. Barden,* 208 W. Va. 163, 539 S.E. 2d 106, 112 (2000), the West Virginia Supreme Court held that "[u]nexcused conduct that results in the entry of a default judgment is no less of an implicit waiver of a right to arbitration than any other procedural forfeiture." Appellants attempt to discount the *Barden* Court's holding by claiming that West Virginia had not adopted an arbitration act at the time of the ruling; this is simply untrue. West Virginia codified an arbitration act as far back as 1926 and has since adopted the Uniform Arbitration Act, as has South Carolina.

West Virginia is not the only state to have found waiver of the right to demand arbitration by virtue of a party's default. *See, e.g.*, *Bland v. Green Acres Group, L.L.C.*, 12 So. 3d 822, 824 (Fla. 4th Dist. App. 2009) ("Here, a default was entered against Bland, the effect of which was to admit the complaint's well pled allegations. . . . Assuming proper service of process and actual knowledge of the case, it is difficult to imagine a more emphatic repudiation of the right to arbitrate than an admission that a court is a proper forum to determine the claim." (internal citations omitted)); *Bojadzijev v. Roanoke Tech. Corp.*, 997 So. 2d 1251, 1253 (Fla. 5th Dist. App. 2009) ("Here, Bojadzijev waived his right to seek arbitration by failing to raise the issue before the trial court in a timely motion to compel arbitration. Accordingly, the trial court did not err in denying Bojadzijev's motion to vacate the default final judgment on this basis."); *Samuel J. Marranca Gen. Contracting Co., Inc. v. Amerimar Cherry Hill Associates Ltd. Partn.*, 610 A.2d 499, 501 (Pa. Super. 1992) (citing *Foster v. Philadelphia Manufacturers*, 140 Pa. Cmwlth. 186, 592 A.2d 131 (1991) ("In the instant case, the pleadings are devoid of any mention of the defense of arbitration and, therefore, we find that it is waived.")); *Sigma Motors, Inc. v. Klien*, 1 CA-CV 07-0831, 2008 WL 4853611, at *3 (Ariz. App. 1st Div. Nov. 6, 2008) ("Affirming the lower court's holding that: The Court further finds that the contractual arbitration provision is a defense that could have been raised and that the failure to raise the right or claim to arbitration under the contract was waived by electing not to answer or defend the underlying action."); *Discount Corp. v. RCK Corp., Inc.*, 110 F.3d 69, 1997 WL 133239, at *1 (9th Cir. 1997) ("Because [defendant] failed to assert the arbitration issue in a timely fashion, we find no merit to his contention that the court should have set aside the default judgment.") (citation omitted); *Cho Yang Shipping*

Co., Ltd. v. American Freight Lines, Ltd., No. 94 Civ. 0347, 1994 WL 577006, at *2 (S.D.N.Y. Oct. 19, 1994) ("[Plaintiff's] failure to initiate arbitration proceedings may have amounted to a breach of contract, in which case [defendant] had the option of asserting a counter-claim or moving to compel arbitration. [Defendant's] options did not include ignoring this action.").

In the present case, Appellants' failure to respond to the complaint and subsequent failure to raise the arbitration provision operates as a waiver of Restorations Specialists' right to demand arbitration.[5]

4. Waiver by Participation in Litigation and Acts Inconsistent with Arbitration Rights

Facts in further support of the argument that Restoration Specialists waived its right to arbitration include the Appellants' filing of affidavits (in support of the motion for continuance and the motion to be relieved from default) and motions (motion for continuance and motion to be relieved from default), appearing at a hearing on June 6, 2016 without raising the arbitration provision, and participating in discovery. Appellants answered PCG's interrogatories and requests for production on July 7, 2016 and then made three separate document productions on July 6, 11, and 13, 2016. It was only after the Court indicated that the motion to be relieved from default may not be granted[6] that Appellants moved to compel arbitration to delay the damages hearing. Even after the motion to compel arbitration was filed by Appellants, Appellants sought to conduct their

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[5] The same would be applicable to Mark and Lynnette Ward; however, they are not signatories to any contract containing any arbitration provision and have no right to demand arbitration.

[6]THE COURT: "Your Motion for Relief from the Entry of Default - I'm not going to rule on yet. There's not much I saw in that affidavit that would give me indication that I would grant that motion. I can tell you that right now. Okay?" (ROA 466, at 11:20-24).

own discovery, but the request was denied by the Master because Appellants are in default. *See* ROA 467 at 9:22–10:1 ("MS. ARIAIL: Your Honor, I would ask since I have in good faith participated in discovery that I at least be allowed to serve some form of discovery related to damages so that I can prepare properly for the damages hearing."). These acts are all inconsistent with the right to demand arbitration.

Pursuant to Section 3 of the FAA, "a party may demand a stay of federal judicial proceedings pending exercise of a contractual right to have the subject matter of the federal action decided by arbitration, unless the party seeking arbitration is 'in default' of that right." *Maxum Foundations, Inc. v. Salus Corp.*, 779 F.2d 974, 981 (4th Cir. 1985) (citing 9 U.S.C. § 3 (1982)). Courts have interpreted the term "default" under Section 3 as a material breach of an arbitration agreement, which includes a party's refusal to arbitrate when arbitration is sought by an opposing party. *See, e.g.*, *Brown v. Dillard's, Inc.*, 430 F.3d 1004, 1010–12 (9th Cir. 2005) ("A party who is in material breach of an arbitration agreement (e.g., by refusing to arbitrate) is in default of that right and cannot compel arbitration."). Here, PCG filed a motion to stay and compel the arbitration of those claims that are subject to the arbitration. The motion was personally served on Appellants, and rather than respond and consent to arbitration, Appellants ignored the pleadings, refusing to arbitrate. Appellants are barred by Section 3 of the FAA from demanding arbitration. If estoppel is applicable in this case, it operates as a bar to Appellants' arbitration demand, not PCG's objection to it. It is Appellants' conduct that has been inconsistent with the intent to arbitrate, and it is PCG who is prejudiced by its reliance on Appellants' inconsistent conduct. *See S.C. Elec. & Gas Co. v. Hix*, 410 S.E.2d 582, 585 (S.C. App. 1991); *infra*, Part V.D.5.a.

5. Appellants' Affirmative Defenses

a. Estoppel

Appellants first argue that PCG is estopped from objecting to Appellants' belated demand for arbitration and from obtaining a default judgment against Appellants because PCG filed a motion to compel arbitration with its complaint. Appellants' Brief at 25. First, as discussed *supra*, Appellants motion sought mediation and arbitration in the event of unsuccessful mediation, and only PCG's claim arising out of Restoration Services' breach of its subcontract with PCG, which contains the arbitration provision, is subject to arbitration. All other claims are wholly independent from the subcontract, can be maintained without any reference to it, and arise out of the bond and indemnity agreements with the surety, Hanover, which have no arbitration provision. Neither Mark or Lynnette Ward are signatories to the subcontract; thus, they have no arbitration provision. They are, however, parties to the indemnity agreement. PCG had every intention of arbitrating with Restoration Specialists, which is why a copy of the motion to compel arbitration was served with the complaint. (ROA 42–60). However, when Restoration Specialists and the other Appellants chose to ignore the pleadings and instead go into default, PCG took steps in reliance on those actions including withdrawing the motion to compel arbitration and referring the case to the Master in Equity. PCG had every right to change its position and pursue a default judgment after personal service was made and no response was received.

Second, Appellants are unable to prove any of the elements of estoppel. The elements of estoppel are: (1) conduct by the plaintiff calculated to convey the impression that the facts are otherwise than and inconsistent with the position he subsequently asserts in his cause of action; (2) plaintiff's intention or expectation that the defendant will act upon such conduct; (3) plaintiff's knowledge, actual or constructive, of the facts; (4)

defendant's lack of knowledge of the facts; (5) defendant's reasonable reliance on plaintiff's prior inconsistent conduct; and (6) defendant's detrimental change of position as a result of his reliance. *Hix*, 410 S.E.2d at 585. PCG has taken no inconsistent position of fact; it chose to withdraw its motion to compel arbitration based on the Appellants' default. PCG had no intention or expectation that Appellants would take any action as they ignored both the complaint and the motion to compel arbitration that were personally served on them. Appellants had full knowledge of all the facts and took no actions in reliance on PCG's conduct. Indeed, it was PCG that changed its position in reliance on the default of the Appellants. Appellants' argument that PCG is estopped fails.

b. Failure to Raise an Affirmative Defense

Appellants argue that 4th Circuit has held the failure to raise arbitration as an affirmative defense does not constitute a waiver of that right, relying on *Patten Grading & Paving, Inc. v. Skanska USA Bldg., Inc.*, 380 F.3d 200, 205 (4th Cir. 2004). However, in *Patten*, the 4th Circuit recognized that the failure to raise arbitration as an affirmative defense in a party's answer can constitute a waiver of the right to arbitration and even recognized that this analysis is distinct from the more common "waiver by participation in litigation" analysis. The *Patten* Court held:

> Although 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 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.

Id. The *Patten* Court did not conduct a separate analysis as it reasoned both arguments (waiver by the failure to raise the affirmative defense of arbitration and waiver by participation in litigation) require a showing of prejudice, which Patten was unable to

demonstrate. In the case *sub judice*, PCG has been severely prejudiced. See *supra*, Part IV.C.3.

Appellants also cite *Maxum Foundations, Inc. v. Salus Corp.*, 779 F.2d 974, 982 (4th Cir. 1985) for the proposition that failing to raise the arbitration provision as an affirmative defense and going into default in the litigation does not operate as a waiver of the right to raise the provision. However, the third-party defendant seeking arbitration in *Maxum* filed its motion to dismiss pursuant to the arbitration clause as part of its answer. Of course, there would be no finding of waiver as the arbitration clause was properly raised. *Id.*

Most importantly, neither of the foregoing 4th Circuit cases cited by Appellants involves a party that failed to answer the complaint and was held in default before attempting to raise the affirmative defense of arbitration by motion months later. By contrast, the *Maxum* defendant sought arbitration by motion as part of its answer to the complaint against it, and the *Patten* defendant answered the complaint and made a motion for arbitration shortly thereafter – a motion for affirmative relief the defendant could make because it was not in default. Appellants spend almost 40 pages attempting to disprove black letter assertions (e.g., that arbitration is an affirmative defense and parties that are in default cannot seek affirmative relief without showing good cause sufficient to lift the default) and citing a plethora of cases where waiver of an arbitration provision is based on active participation in litigation inconsistent with arbitration rights.[7] However, in its 50-page brief, Appellants cite only one case in the context of a defaulting party moving for

[7] PCG asserts Appellants have waived their right to demand arbitration even under this test as was discussed more fully *supra*, Part V.D.4.

arbitration, the Supreme Court of Utah's opinion in *Cedar Surgery Center, LLC v. Bonelli*, 96 P. 3d 911, 2004 UT 58 (2004).

c. The Cedar Surgery Center case

In the one case Appellants cite in the context of a defaulting party moving for arbitration, the Utah Court reasons that the failure of the defendants to answer the complaint and participate in the litigation evidenced their intent to enforce the parties' arbitration provision.[8] However, in this case, the Appellants' failure to respond to the complaint and the accompanying motion to stay the litigation and compel arbitration evidences the opposite. Here, PCG served its own motion for arbitration with its complaint. If Restoration Specialists intended to enforce the arbitration provision, it could have simply answered and consented to arbitration.[9] Further, in this case Appellants did participate in the litigation by appearing at hearings, filing two motions and two affidavits, answering PCG's written discovery and providing three separate document productions to PCG all before raising the arbitration provision. When the Appellants chose to ignore the pleadings, PCG took steps in reliance on that inaction, including asking the circuit court to refer the case and withdrawing its own motion to compel arbitration. As the *Cedar Surgery Center* Court stated, Appellants should have "raised the contractual arbitration clause in an answer...and then brought a motion to compel arbitration, rather than simply ignoring" the

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[8] "By declining to answer Cedar Surgery's complaint or otherwise respond to the litigation, the Bonellis were, in effect, refusing to acknowledge Cedar Surgery's efforts to circumvent the arbitration process with which it had contractually agreed to abide." *Cedar Surgery Ctr., LLC*, 96 P.3d at 915.

[9] The failure of the Appellants to appear and consent to the arbitration motion made PCG constitutes a default under the FAA at 9 U.S.C. § 3 (1982) and operates as a bar to Appellants belated and improper arbitration demand as was discussed in more detail in section V.D.4 of this brief.

litigation. *Id.* at 915. Appellants only sought to compel arbitration after they were unsuccessful before the Master. Appellants' motion to compel arbitration is more akin to forum shopping than preserving any contractual rights. As the Pennsylvania court stated: Appellants "[h]ad every opportunity to raise and pursue the issue of arbitration but failed to do so. [Appellants] cannot avail themselves of the judicial process and then pursue an alternate route when they receive an adverse judgement. *DeLage Linden Fin. Services, Inc. v. Raynes, McCarty, Binder, Ross & Mundy*, 51 Pa. D. & C. 4th 57, 61–62 (Pa. Com. Pl. 2001) (internal citations omitted).

VI. CONCLUSION

Appellants are in default, and this appeal was filed before a damages hearing was held or a final judgment entered. Being unsuccessful before the Master, Appellants moved for arbitration to delay this case. This Court should dismiss this interlocutory appeal and remand.

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On this 26th day of September, 2017
Charleston, South Carolina

IN THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM CHARLESTON COUNTY
Court of Common Pleas
The Honorable Mikell R. Scarborough, Master in Equity

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2016-CP-10-1143
Appellate Case No.: 2016-002308

Palmetto Construction Group, LLC Respondent,

v.

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

CERTIFICATE OF COUNSEL PURSUANT TO RULE 211(b) SCRAP

The undersigned certifies that the Final Brief of Appellant complies with Rule 211(b) SCRAP.

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