The State of South Carolina
In the Supreme Court

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S.C. SUPREME COURT

APPEAL FROM CHARLESTON COUNTY
Court of Common Pleas for the Ninth Circuit

Mikell R. Scarborough, Master-In-Equity

Appellate Case No.: 2019-002052
Case No. 2016-CP-10-1143

Palmetto Construction Group, LLC…….……Respondent,

v.

Restoration Specialists, LLC, Reuben Mark Ward, and Lynnette Pennington Ward….Petitioners.

RESPONDENT'S BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Treatises

ISSUES ON APPEAL

1. Whether the Court of Appeals erred in dismissing an appeal after finding no appealable issue before it.

2. Whether a party properly placed in default may move to compel arbitration.

STATEMENT OF THE CASE

Respondent Palmetto Construction Group, LLC ("PCG") filed suit against Petitioners on February 12, 2016 (**App. p. 0179**), alleging misappropriation of funds from a construction project for the Department of Veterans Affairs, failure to pay subcontractors and suppliers, and defaults on agreements with PCG and the surety, leaving PCG responsible to pay Petitioners' debts (of over $1.4 million) to the surety and the subcontractors.

I. Trial Court Proceedings

Petitioners were personally served with the summons and complaint on March 14, 2016. **App. p. 0236**. When Petitioners did not answer within 30 days, Respondent moved for default on April 18, 2016 (**App. p. 0233**), and a default order was entered on April 21, 2016. **App. p. 0173**. The matter was then referred to the Master in Equity for a default damages hearing. **App. p. 0173**. The damages hearing was scheduled on June 6, 2016. **App. p. 0649**.

On June 3, 2016, Petitioners filed a motion to be relieved from default (**App. p. 0254**) and attached an affidavit that sought to explain why the default occurred:

> when I received the Summons and Complaint for the instant action, I thought that it was related to my arrangements with [the surety]. I am not an attorney and did not understand that the above captioned action was separate and apart from the bond claims that I have been working directly with [the surety] to address.[1]

[1] There was no suit filed by the surety.

Affidavit of Reuben Mark Ward at ¶¶ 9–10 (**App. p. 0245**). Neither the affidavit nor the motion cited arbitration as a reason for failing to answer. On July 11, 2016, Petitioners filed a motion to compel arbitration. **App. p. 0260**.

Petitioners' motions were denied by Order dated July 14, 2016. **App. p. 0174**. The Order set a default damages hearing for October 4, 2016 and was served on all parties by the Court on July 18, 2016. Petitioners filed a motion to reconsider pursuant to Rule 59 SCRCP on July 27, 2016. **App. p. 0295**. The motion to reconsider was scheduled to be heard by the Court on October 11, 2016. **App. p. 0656**.

Petitioners wrote the Court on September 7, asking that the motions be heard in advance of the damages hearing. **App. p. 0658**. At that time, the Court elected to keep the hearing as originally scheduled with the damages hearing on October 4 and the motion to reconsider be heard on October 11.

II. Notices of Appeal and Appellate Proceedings

However, on September 30, 2016, PCG was served with a notice of appeal of the order denying the motion to lift the default (**App. p. 0669**), which it immediately moved to dismiss. **App. p. 0501**. The parties appeared before the trial court on October 4, 2016 (**App. p. 0641**), but because the notice of appeal divested the trial court of jurisdiction, the damages hearing did not go forward. Instead, the trial court allowed the parties to make a record of their respective positions, a step taken as the procedural posture of the case was unusual, considering (i) the appeal of the interlocutory order denying the motion to lift the default was untimely and (ii) the Rule 59 and arbitration motions remained pending.

On October 5, 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. **App. p. 0709**.

Also on October 5, PCG was served by facsimile with a copy of a second notice of appeal, different than the one previously served, which attached the July 14, 2016 Order and portions of the transcript of hearing. **App. p. 0688**. On October 6, 2016, PCG's counsel was served by facsimile with a third version of the notice of appeal. **App. p. 0699**. On October 13, 2016, the Court of Appeals sent a letter to all counsel stating that the October 6 notice of appeal was being returned to Petitioners' counsel together with the transcript, as the transcript is not the equivalent of an order and is not properly included with a notice of appeal. PCG moved to dismiss the appeal noticed October 5 (**App. p. 1971**), and the Court of Appeals granted the motion on November 10, 2016. **App. p. 0177**.

Following the entry of the trial court's October 28, 2016 Order denying Petitioners' motion to amend their answer and motion to stay and compel arbitration (**App. p. 0175**), Petitioners' counsel filed a fourth notice of appeal on November 14, 2016. **App. p. 0677**.

PCG moved to dismiss this third appeal as interlocutory and on the basis that the denial of Petitioners' motion to compel arbitration was not appealable because the motion to compel arbitration was improper for a defendant in default. The Court of Appeals denied the motion on February 1, 2017, reserving the issue of appealability to the appeal in chief. **App. p. 0178**.

The merits of the appeal were briefed, and oral argument was held on April 2, 2019. On June 26, 2019, the Court of Appeals entered an order dismissing Defendants' appeal for lack of jurisdiction. Ct. App. Order at 7, (**App. p. 0010)** ("We find the master's July 14, 2016 and October 28, 2016 orders are not appealable. Moreover, because Petitioners were in default, they waived their right to assert arbitration as a defense.").

STANDARD OF REVIEW

Whether a trial court erred in denying a motion to relieve a party from default is reviewed on an abuse of discretion standard and will only be reversed if there is no evidence supporting the trial court's decision. *Sundown Operating Co. v. Intedge Indus., Inc.*, 383 S.C. 601, 606, 681 S.E.2d 885, 888 (2009) ("The trial court's decision [of whether to set aside an entry of default] will not be disturbed on appeal absent a clear showing of abuse of that discretion."). Review of the denial of a motion to compel arbitration is *de novo*, with deference given to the factual findings of the trial court. *Rich v. Walsh*, 357 S.C. 64, 68, 590 S.E.2d 506, 508 (Ct. App. 2003).

ARGUMENT

I. Withdrawal of Arbitration Motion and Default

The basis of this lawsuit is that Petitioners Mark Ward and Restoration Specialists, LLC stole $1.4m from a federal construction project for the Department of Veterans Affairs[2] on which Respondent, Palmetto Construction Group, and its principals were guarantors on the surety bond.[3] Given the scope of the ensuing responsibility to the surety, Respondent's only hope of survival was to win the race to get between Petitioners and the last funds that would be distributed by the Department of Veterans Affairs. Arbitration usually being an expedient means of resolution, Respondent initially sought to compel arbitration.

However, when—after being personally served—Petitioners failed to respond to the pleadings and went into default, zealous representation and the urgent necessity of expedient

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[2] Not for the first time. Petitioners request this Court take judicial notice of Case No. 2017-CP-10-3816, filed in the Charleston County Circuit Court, a case similar to this one involving a separate project for the Department of Veterans Affairs. A confession of judgment was entered in April 2020 and has been defaulted upon.

[3] PCG was forced into insolvency, and its principals honored their debt to the surety who paid when the funds went missing.

resolution required the withdrawal of the motion to compel arbitration, a motion for an entry of default, and referral of the case to the Master in Equity. Respondent had every right to change its position and pursue a default judgment after personal service was made and no response was received. Indeed, Respondent's counsel had an obligation to its client to do so.

II. Court of Appeals Properly Found It Lacked Jurisdiction

Petitioners appealed two orders of the trial court: one declining to lift the default, and one declaring as a nullity a motion to compel arbitration filed while in default. For the reasons that follow, neither order was immediately appealable, and the Court of Appeals did not err in dismissing the appeal.

A. No Default Judgment

An order denying a motion to be relieved from default is not appealable until after final judgment. *Thynes v. Lloyd*, 294 S.C. 152, 154, 363 S.E.2d 122, 123 (Ct. App. 1987). No damages hearing has occurred, because Petitioners noticed an appeal four days before the damages hearing was to take place, thus depriving the trial court of jurisdiction.[4] As there was no damages hearing, there was no judgment, and no ability to appeal on the issue of the propriety of default.

B. Petitioners' Motion to Compel Arbitration Was a Nullity

Petitioners were in default when they filed a motion to compel arbitration. The actions available to a party in default are limited to moving to be relieved from default and, failing that,

[4] Petitioners contend the Court of Appeals' order was contrary to the interests of judicial economy and would lead to "inevitable additional appeals." Petitioners' Brief at 16. However, had Petitioners simply waited a short time for the entry of a default judgment, the entire case would have been appealable. It was Petitioners' decision to appeal when they did that risks piecemeal appeals.

cross examining witnesses at a damages hearing. They do not include seeking affirmative relief. Petitioners' motion to compel arbitration was therefore a nullity and was properly denied as such.

The Court of Appeals found that, under South Carolina law, Petitioners waived any right to arbitrate. This was not a finding of the traditional "waiver" in the arbitration context, where a party is found to have waived arbitration due to its utilization of the machinery of litigation; rather, it was a finding that a party in default has, as a matter of law, lost the right to compel arbitration.

Because the motion was a nullity, *i.e.*, it did not exist, no appeal lies from a court order saying so.[5]

1. A Party in Default Cannot Seek Affirmative Relief

This Court has stated the following about parties in default:

> It is well settled that by suffering a default, the defaulting party is deemed to have admitted the truth of the plaintiff's allegations[6] and to have conceded liability.

Roche v. Young Bros., of Florence, 332 S.C. 75, 81, 504 S.E.2d 311, 314 (1998) (citations omitted). Having conceded liability, a party in default has limited recourse before the courts:

> Though a defaulting party may be entitled to notice of the damages hearing, that party is limited to cross-examining witnesses and objecting to evidence.

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[5] Petitioners contend that "an order finding that a party waived its right to compel arbitration is immediately appealable," citing *Liberty Builders, Inc. v. Horton*, 336 S.C. 658, 521 S.E.2d 749 (Ct. App. 1999). However, the undersigned could find no support for this proposition in the cited case (other than the proposition that a denial of a properly filed motion to compel arbitration is immediately appealable, whether or not it contains a finding of waiver), nor in any other reported case in this state.

[6] *See infra*, Part II.B.2.

Id. at 81–82, 504 S.E.2d at 314. Further, a party's "status as a defaulting party [is] not vitiated simply because it later chose to challenge the default judgment rendered against it." *Id.* at 82, 504 S.E.2d at 315.

Accordingly, the Court of Appeals did not err when it ruled:

> Appellants' default should not be excused because they chose to file a claim for arbitration to remove their default status. Therefore, the master correctly found Appellants' motion to stay and compel arbitration was not proper due to Appellants' default status.

Ct. App. Order at 4 (**App. p. 0008**).

When—after being personally served with the summons and complaint—Petitioners failed to answer, Petitioners were properly placed in default. Because they failed to show good cause for lifting the default,[7] Petitioners' remained in default at the time they sought to move to compel arbitration, and the motion is therefore a nullity.

2. A Defaulting Party Admits the Allegations of the Complaint

A defaulting party forfeits the right to answer the complaint and is deemed to have admitted the truth of the allegations against it, thus conceding liability. *Howard v. Holiday Inns, Inc.*, 271 S.C. 238, 242, 246 S.E.2d 880, 882 (1978) ("By defaulting, a defendant forfeits his right to answer or otherwise plead to the complaint. In essence, the defaulting defendant has conceded liability." (internal quotation omitted)).

Among of the allegations in the complaint was that jurisdiction was vested in the trial court and that venue was proper there. *Complaint* at ¶ 6 (**App. p. 0183**). Admission of those allegations constitutes an "emphatic repudiation" of the right to compel arbitration. *See Bland v.*

[7] Respondents note that Petitioners' affidavit purportedly explaining their lack of a response to the pleading nowhere mentions a right to arbitrate or asserts arbitration as a basis for failing to file an answer. **App. p. 0245**.

Green Acres Grp., 12 So.3d 822, 824 (Fla. App. 2009) ("Assuming proper service 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.").

3. Affirmative Defense

Arbitration is an affirmative defense that is waived if not raised. *See Wham v. Shearson Lehman Bros., Inc.*, 298 S.C. 462, 466, 381 S.E.2d 499, 502 (Ct. App. 1989) (quoting 5 Am. Jur. 2d *Arbitration & Award* § 51 at 556–57 for the proposition that "one's right to arbitrate given by contract may be waived by failing to raise the right in an answer"); *see also 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."); *Howard v. S.C. Dept. of Highways*, 343 S.C. 149, 155, 538 S.E.2d 291, 294 (Ct. App. 2000) ("Affirmative defenses are waived if not pled.").

By defaulting, Petitioners waived the right to file a pleading or to contest liability, and thus also waived the right to move the court to compel arbitration.

4. Prejudice

When an argument for waiver is based on utilization of the machinery of litigation, "[t]he party seeking to establish waiver has the burden of showing prejudice through an undue burden caused by a delay in the demand for arbitration." *Johnson v. Heritage Healthcare of Estill, LLC*, 416 S.C. 508, 513, 788 S.E.2d 216, 218 (2016). Here, the finding of waiver was on a different basis, namely Petitioners' default status. *Supra*, Part II.B.

Petitioners nonetheless argue that the record lacks a showing of prejudice that would justify a finding of waiver of the arbitration right. In South Carolina, a party cannot point to a lack of evidence when its own conduct is the reason for the absence of that evidence. *See*

Champion v. Whaley, 280 S.C. 116, 121–22, 311 S.E.2d 404, 407 (Ct. App. 1984) ("The defendant cannot take advantage of the uncertainty caused by his own wrongdoing.").

Here, four days before the default damages hearing was to take place—a hearing at which PCG was to give testimony of what the damages it had and would continue to suffer—Petitioners served their first notice of appeal. This deprived the trial court of jurisdiction to conduct the hearing, and it prevented evidence being offered of the nature of the harm suffered by PCG and the prejudice that it would—and ultimately did[8]—suffer as a result of Petitioners' actions and the delay in vindication of PCG's claims. Petitioners cannot rely on an absence of that evidence to argue the absence of waiver.

III. Petitioners' Remaining Arguments

Petitioners' remaining arguments may be responded to by noting that, as the Court of Appeals found it had no jurisdiction, the majority of its holding is dicta. However, Respondents provide additional responses to certain of the arguments as follows.

A. Equitable Estoppel

Petitioners contend that "Respondent is equitably estopped from denying the applicability of the mandatory mediation/arbitration clause as to all Petitioners" because Respondent filed a motion to compel arbitration along with its complaint. For the reasons stated *supra*, Part I, this argument must fail.

B. *Cedar Surgery*

Petitioners rely heavily on a case out of Utah for the proposition that a defaulting party may nonetheless move to compel arbitration. This reliance is misplaced. The Court in *Cedar*

[8] *See supra*, note 3.

Surgery v. Bonelli was reviewing an order *lifting* a default. *Cedar Surgery Ctr. v. Bonelli*, 96 P.3d 911, 913 (Utah 2004). That ruling, like the Master's ruling in this case denying relief from default, would be reversible only if the trial court abused its discretion. *Id.*; *Sundown Operating Co. v. Intedge Indus., Inc.*, 383 S.C. 601, 606, 681 S.E.2d 885, 888 (2009) ("The trial court's decision [of whether to set aside an entry of default] will not be disturbed on appeal absent a clear showing of abuse of that discretion."). The *Cedar Surgery* court, like the Court of Appeals here, found no abuse of discretion given the particular circumstances of the case.[9]

C. The Individual Petitioners Cannot Compel Arbitration

Petitioners contend 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.

The 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), 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:

[9] There, the first action taken by the Petitioner in that case was to move to compel arbitration, and so the court found that the reason for failing to answer was in reliance on and consistent with an arbitration right. *Cedar Surgery*, 96 P.3d at 915. This is not the case here, as evidenced by the affidavit of Mark Ward, which includes no mention of arbitration. **App. p. 0245**.

> [E]stoppel 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, PCG's claims against Mark and Lynette Ward are not intertwined or interwoven with the claims under the subcontract between Restoration Specialists and PCG. PCG's complaint alleges a breach of contract against Petitioner Restoration Specialists for its failure to pay PCG the funds due for the work PCG performed under a subcontract for concrete construction, a subcontract containing an arbitration provision. PCG also sued Petitioner Mark Ward for actual and constructive fraud, negligent misrepresentation, and equitable and injunctive relief regarding misappropriation of funds from a federal project, a misappropriation that resulted in over $1.4 million in claims by subcontractors on the payment bond and a demand for indemnity from the surety pursuant to the indemnity agreement. A final claim was asserted against all Petitioners regarding their responsibilities to pay funds claimed by subcontractors against the surety bond.

The claims against the individual Petitioners are unrelated to whether PCG was paid under its subcontract for concrete work; 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. PCG's claims

against Mark & Lynette Ward arise out of the bond and indemnity agreement with the surety, Hanover.

The subcontract and indemnity agreements are distinct from one another. For example, 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 proof required for the claims against the Wards is thus different to that required for the breach of subcontract claim.

Only the latter is subject to arbitration. Petitioners are in error when they state it is "clear" that the claims against Restoration and against the Wards are intertwined. Petitioner's Brief at 22.

CONCLUSION

A party that unjustifiably fails to respond to a pleading in the courts of this State should not be permitted to circumvent that failure by belatedly moving to compel arbitration. This Court should hold that a party in default cannot move to compel arbitration and remand the case to the trial court for a default damages hearing.

[signature on following page]

Respectfully Submitted:

EPTING & RANNIK, LLC

This 21st day of September, 2020
Charleston, South Carolina

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