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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA

In the Supreme Court

APPEAL FROM CHARLESTON COUNTY

Court of Common Pleas for the Ninth Circuit

The Honorable Bentley Price, Circuit Court Judge

Case No. 2019-CP-10-00178

Supreme Court Case No. 2020-000370

J. Daniel Mahoney.....Respondent,

v.

The Muhler Company, Inc. and Henry Hay III, in his individual capacity……...…. Petitioners.

BRIEF OF RESPONDENT

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STATEMENT OF ISSUES ON APPEAL:

1. Whether the trial court's order partially granting a motion to compel arbitration is immediately appealable.
2. Whether the trial court erred in refusing to enforce the arbitrator selection clause set forth in the arbitration provision.

STATEMENT OF THE CASE:

On January 15, 2008, Plaintiff/Respondent Mahoney became CEO of the Muhler Company, Inc. ("Muhler"). Later that year Mahoney became a minority shareholder in Muhler. (**The Muhler Company, Inc Common Stock Ledger, Appendix P. 54**). The President and founder of Muhler, Henry Hay, III ("Hay") is the majority shareholder of the Company. Together Hay and Mahoney represent one hundred percent of the shares in Muhler.

As the two shareholders in Muhler, Mahoney and Hay each receive one vote per share. This voting scheme creates an imbalance when the parties disagree and allows majority shareholder Hay to control all company decisions and disregard Mahoney's concerns.

This imbalance in voting power appeared in a shareholder meeting on October 25, 2016, when Mahoney was presented with a proposed amendment to the Muhler Bylaws that included an arbitration provision. Mahoney received no prior notice of this proposal, nor did he receive any copy of the proposed amendment prior to the meeting. After objecting to the vote for lack of notice, the meeting was rescheduled to a later date so Mahoney could review the new provision. (**November 16, 2016 Shareholder Meeting Transcript, Pgs. 3-9, Appendix Pgs. 187-193**). Section (2) of the proposed arbitration provision provides the following method for selecting the arbitrator panel:

> "There shall be three arbitrators, each of whom shall be a Certified Public Accountant ("CPA") licensed in the State of South Carolina.
>
> The claimant or claimants shall select one arbitrator within fifteen (15) days following the notice of the demand for arbitrator; provided, that, if there is more than one claimant, such arbitrator shall be selected by the majority vote of the claimants.
>
> The respondent or respondents shall select one arbitrator within fifteen (15) days following notice of the demand for arbitration; provided, that, if there is more than one respondent, such arbitrator shall be selected by the majority vote of the respondents.
>
> The third arbitrator shall be an employee of the Corporation's accountant. This third arbitrator will be appointed even in the event that the corporation is a claimant or respondent."

After reviewing the provision, Mahoney sent Hay a letter on November 15, 2016 explaining that he objected because the panel was designed to favor Muhler in any action brought against Muhler or its officers. Mahoney expressed concern over the proposed arbitration provision for two reasons. First, it required three Certified Public Accountants adjudicate "any claim," even though a CPA would not have the expertise to analyze issues involving South Carolina corporate law. Second, after each party selects their own arbitrator, the third would be a CPA employed by Muhler, which Mahoney believed fostered a clear bias within the arbitration panel. (**November 16, 2016 Shareholder Meeting Transcript, Pgs. 7-9, Appendix Pgs. 191-193**).

At the rescheduled Special Shareholder Meeting on November 16, 2016, Mahoney again stated on the record that he objected to and voted against the arbitration provision. He stated, "the minutes…should reflect the fact that the majority stockholder voted for the arbitration provision and the minority stockholder voted against it." (**November 16, 2016, Shareholder Meeting Transcript, P. 6, Lines 6-10, Appendix Pg. 190**). Despite Respondent's

objection, it was adopted into the Amended Bylaws by Hay's majority vote. (**November 16, 2016, Shareholder Meeting Transcript Pgs. 3-4, Appendix Pgs. 187-88; October 14, 2016, Amended By Laws, Appendix P. 202).**

This biased arbitration provision became relevant nearly two years later, when Mahoney was terminated as CEO of Muhler. On September 18, 2018, Hay voted to terminate Mahoney from his role as CEO during a Shareholder Meeting. Mahoney hired an employment attorney to represent him in a lawsuit against Muhler pursuant to the South Carolina Payment of Wages Act, S.C. Code Ann. § 41-80-10 for his salary and benefits, or in the alternative, under a breach of contract theory ("Employment Lawsuit").

Subsequently, Mahoney hired this law firm to represent him in his capacity as a minority shareholder. A lawsuit was filed on January 14, 2019 alleging 1) Breach of Contract (the parties' Shareholder Agreement); 2) Breach of Fiduciary Duty; 3) Specific Performance; 4) Court Action to Protect Shareholders pursuant to the South Carolina Statutory Close Corporation Act; and 5) Court Action to Dissolve the Muhler Corporation pursuant to *Id.* § 33-14-300.

On May 15, 2019, Muhler moved to stay the Employment Lawsuit and compel arbitration before the Honorable Judge Bentley Price, which was ordered on May 17, 2019. Mahoney's Employment Lawsuit was arbitrated in December 2019 and the arbitration panel found in favor of Muhler. (**December 12, 2019 Arbitration Order, Appendix P. 79)**.

On May 31, 2019, Petitioners moved to stay and compel arbitration in the Shareholder Lawsuit, again before Judge Price. Mahoney's counsel in this suit highlighted the unfair arbitrator appointment method found in the arbitration provision. Judge Price granted the motion to compel arbitration, but for purposes of fairness, substituted the unfair selection method with S.C. Code Ann. § 15-48-200(a) (1978) to provide an unbiased method of appointing

arbitrators to the panel for the parties' dispute. (**June 24, 2019 Order Granting Defendant's Motion to Stay and Compel Arbitration, Appendix P. 90**). Specifically,

> "If the arbitration agreement provides a method of appointment of arbitrators, this method shall be followed. In the absence thereof, there shall be three arbitrators with one chosen by the party making the demand for arbitration, one chosen by the party against whom demand is made and third being chosen by those two chosen by the parties."

Judge Price's June 2019 Order is currently on appeal and being reviewed by this Honorable Court. Petitioners argue that that the Order functioned as denial of the right to arbitrate, which is final and immediately appealable.

Petitioners also have a pending appeal with the South Carolina Court of Appeals seeking the confirmation of the arbitration award in Case Number 2018-CP-10-5077, confirmed on March 27, 2020 in Case Number 2019-CP-10-00178. Judge Price denied the motion to "confirm" the award from the Employment Lawsuit into the Shareholder Lawsuit, because the two lawsuits are separate and raise different issues to the court on June 17, 2019.

STANDARD OF REVIEW

The issue on cert to this court involves a question of statutory interpretation, which is a question of law that this court reviews *de novo*. *Town of Summerville v. City of N. Charleston*, 378 S.C. 107, 110, 662 S.E.2d 40, 41 (2008); *Eldridge v. City of Greenwood*, 331 S.C. 398, 503 S.E.2d 191 (1998)).

STATEMENT OF THE ARGUMENTS

1. The Court's Partial Order Granting the Petitioner's Motion to Compel Arbitration, Is Not Immediately Appealable

The Petitioners claim that the trial court's Order granting the motion to compel arbitration, but changing the arbitrator selection method, is immediately appealable, because it functions as a denial of their motion to compel arbitration. Respondent asserts that Petitioners have not been denied the right to arbitrate, rather, they were barred from arbitrating the dispute with a biased arbitration panel, and thus the Order is not immediately appealable.

First, the Petitioners argue that partially amending or severing the arbitrator selection method invalidates the entire provision and thus their right to arbitrate. Petitioners rely on *Simpson v. MSA of Myrtle Beach, Inc.*, 373 S.C. 14, 25, 644 S.E.2d 663, 669 (2007). In *Simpson* the Court states that "severability clauses have been used to remove the unenforceable provisions in an arbitration clause while saving the parties' overall agreement to arbitrate." *Healthcomp Evaluation Servs. Corp. v. O'Donnell*, 817 So. 2d 1095, 1098 (Fla. 2d DCA 2002) (Fla. Ct. App. 2d Dist. 2002) (holding that an arbitration clause was divisible and therefore a severability provision acted to remove the unenforceable provision from the arbitration clause without affecting the intent of the parties). Further, the court in *Simpson* explained that "[S.C. Code Ann. § 36-2-302(1)], permits this Court to 'refuse to enforce' any unconscionable clause in a contract or to 'limit its application so as to avoid an unconscionable result." The Court in *Simpson* also cited a D.C. Circuit Court opinion stating that, "a critical consideration in assessing severability is giving effect to the intent of the contracting parties…If illegality pervades the arbitration agreement such that only a disintegrated fragment would remain after hacking away the unenforceable parts, the judicial effort begins to look more like rewriting the contract than fulfilling the intent of the parties." *Booker v. Robert Half Int'l, Inc.*, 367 U.S. App. D.C. 77, 413 F.3d 77, 84-85 (D.C. Cir. 2005).

This Court must look to the effect of the Trial Court's Order on the intent of the parties. The Muhler Bylaws intended to offer a non-judicial remedy to adjudicate disputes between Muhler and its opposing party. However, the provision allowed for the selection of an arbitrator panel biased in Muhler's favor. The Trial Court's revision of the arbitrator selection method did not undermine the intent of the provision to arbitrate, rather it rid the inherent bias within the arbitrator selection method to render it fair and enforceable. The Petitioners' insistence on using the unfair provision indicates their desire to use a panel that is biased in their favor, and to avoid adjudicating the claims fairly. Judge Price's Order was legally appropriate and equitable. It should be upheld.

Appellant does agree with one point from Petitioners' Brief. As Petitioners state, they will appeal any arbitration award not in their favor. As such, we join in the Petitioners' request for this Honorable Court to make a determination, at this time, as to the validity of the Lower Court's Order so we don't have to deal with this issue after an arbitration panel has ruled. As will be stated below, several of the Respondent's claims as a minority shareholder are not subject to arbitration since there is no written agreement to arbitrate. Regardless, we join in the Petitioners' request for this Honorable Court to determine, at this juncture, the validity of the arbitration provision at issue and its enforceability. Otherwise, we will continue on endless litigation and appeals.

2. The Trial Court Did Not Err in Partially Granting the Motion to Compel Arbitration

Petitioners assert that the Trial Court erred in granting the Petitioners motion to compel arbitration but altering the arbitrator appointment method. They argue "form over substance," stating that the Order effectively denied the right to arbitrate, and thus is immediately appealable.

This argument relies on two assumptions, the first that the arbitrator selection method was ever valid to begin with, and that revising the arbitrator selection method to make it fair denies the Petitioners the right to arbitrate.

a. The Arbitration Clause was Unenforceable Because it Was Never Agreed to In Writing.

First, there is a strong claim that the Arbitration Provision within the Muhler Bylaws was never enforceable as to Mahoney's minority shareholder claims. Muhler is a registered Statutory Close Corporation, therefore, the Statutory Close Corporation Act applies.

According to S.C. Code Ann. § 33-18-400(b) and (c):

> (b) A shareholder must commence a proceeding under subsection (a) in the circuit court of the county where the corporation's principal office or, if none in the State, its registered office is located. **The jurisdiction of the court in which the proceeding is commenced is plenary and exclusive**.
>
> (c) **If a shareholder has agreed in writing** to pursue a nonjudicial remedy to resolve disputed matters, he may not commence a proceeding under this section with respect to the matters until he has exhausted the nonjudicial remedy. (emphasis added)

Here, Respondent **never** agreed to be bound to an arbitration provision. Rather, an arbitration clause was presented at a Special Shareholder's Meeting without notice, was objected to by the Respondent, and ultimately forced into the Amended Bylaws by Petitioner Hay through his majority voting power. It is clear from the shareholder meeting transcript that Mahoney did not approve of this arbitration provision and had no power to prevent it from being incorporated into Muhler's Amended Bylaws. **(November 16, 2016, Shareholder Meeting Transcript, P. 6, Lns. 6-10, Appendix P. 190).**

It is clear from Mahoney's letter explaining his disapproval of the arbitrator selection method, and his comments from the November 16, 2016, Shareholder Meeting Transcript that he

strongly opposed the arbitrator selection method contained in the amended bylaws. He voted against the provision, and Hay, rather than altering the provision to address Mahoney's valid concerns, voted to adopt it into the bylaws. There is NO agreement to arbitrate – there is certainly no written agreement. Because there was no agreement nor any agreement in writing other than a forced vote by an oppressive majority shareholder, there is no obligation at all to arbitrate the dispute over Mahoney's minority shareholder claims.

b. The Arbitration Provision is Unenforceable as Written Because it Was Biased and Unconscionable

Respondent also asserts that the arbitration provision was unfair on its face and was unenforceable as written. The South Carolina Uniform Arbitration Act, S.C. Code Ann. § 15-48-10(a) states that arbitration clauses are valid, "save upon such grounds as exist at law or in equity for the revocation of any contract." The South Carolina Code provides that "[i]f a court as a matter of law finds any clause of a contract to have been unconscionable at the time it was made, the court may refuse to enforce the unconscionable clause, or so limit its application so as to avoid any unconscionable result." *Id.* § 36-2-302(1) (2003).

An arbitration agreement is considered unconscionable under S.C. Code Ann. § 15-48-10(a) (1978) when the provision creates an absence of a meaningful choice or contains one-sided terms. *Lucey v. Meyer*, 401 S.C. 122, 140, 736 S.E.2d 274 (2012). Further, the "absence of meaningful choice on the part of one party generally speaks to the fundamental fairness of the bargaining process in the contract at issue *Simpson*, 373 S.C. at 25, 644 S.E.2d at 669.

The Arbitration provision in Muhler's Amended Bylaws could not be challenged in a meaningful way, as minority shareholders in close corporation have limited voting power. Mahoney, as the minority shareholder, could not effect real change or successfully oppose matters favored by the majority shareholder.

Further, the arbitrator selection method created a biased panel which was unfair on its face. Mahoney expressed concern over the clear bias of the panel multiple times and was aware that the panel would be disfavor any opponent of the Muhler Company. Judge Price's decision to modify the arbitration selection method was appropriate under South Carolina law and should be upheld.

c. Courts Can Revise Terms of a Contract to Make it Fair and Enforceable

Courts have the discretion to void an unconscionable contract or modify unfair contractual terms to make them fair or revise them to reflect the default rules set forth in the Statute. Petitioners properly state the general principle that "it is not the function of the court to rewrite contracts for parties." *Simpson*, 373 S.C. at 34, 644 S.E.2d at 669 (quoting *Lewis v. Premium Inv. Corp.*, 351 S.C. 167, 171, 568 S.E.2d 361, 363 (2002)). However, like other contracts, arbitration agreements may be invalidated by "generally applicable contract defenses, such as fraud, duress, or unconscionability." *Rent-A-Center, W., Inc. v. Jackson*, 561 U.S. 63, 130 S. Ct. 2772 (2010).

The South Carolina Courts have held partisan and one-sided arbitration panels, or contracts that create an absence of a meaningful choice for one party, to be unconscionable. *Simpson*, 373 S.C. 14, 644 S.E.2d 663; *Brown v. Dick Smith Nissan, Inc.*, 414 S.C. 101 (2015). As a minority shareholder, Mahoney did not have enough voting power to block the adoption of the arbitration provision to the Amended Bylaws, creating an absence of a meaningful choice. Further, because the arbitration provision is unfair and biased in favor of the Muhler Company, the Court can and did revise the provision to make it fair. Here, the Court permitted the parties to arbitrate, but altered the unfair provision to reflect the neutral arbitrator selection method set forth in the South Carolina Code. This preserved the right to arbitrate but adopted a fair arbitrator selection method.

Petitioners also argue that by altering the arbitrator selection method, the Trial Court assumed a function that should have been left to the arbitrators. Respondent believes this argument

lacks merit and is circular. If an arbitrator panel biased toward a party is charged with the duty of determining its own bias, it is unlikely that the panel will amend the arbitration selection method itself to appoint a neutral third arbitrator who no longer favors Muhler. Again, neutral courts can revise contracts to make them fair, which is what the Trial Court did in its Order.

CONCLUSION

The Respondent asserts that the trial court did not err in partially granting Petitioners' motion to compel arbitration. By altering the arbitrator selection method of the Muhler Amended Bylaw's the court preserved the right of the parties to arbitrate but eliminated bias in the panel. The Trial Court's Order is not immediately appealable because it did not deny the Petitioners the right to arbitrate, it only altered the provision to ensure the process is fair.

Respectfully Submitted,

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