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NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2009-CA-000657-MR

ENERGY HOMES, A DIVISION OF
SOUTHERN ENERGY HOMES, INC. APPELLANT

v.

APPEAL FROM DAVIESS CIRCUIT COURT
HONORABLE THOMAS O. CASTLEN, JUDGE
ACTION NO. 08-CI-01493

BRIAN PEAY AND LORI PEAY APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: CAPERTON, NICKELL AND THOMPSON, JUDGES.

THOMPSON, JUDGE: Energy Homes, A Division of Southern Energy Homes, Inc. (SEHI), appeals from an order denying its motion to compel arbitration. SEHI argues the trial court erred by finding: (1) the terms of a prior purchase agreement precluded a subsequent arbitration agreement; (2) there was no privity of contract and no consideration to support the arbitration agreement; and (3) the arbitration

agreement was unconscionable. We agree that the arbitration clause was unconscionable.

On November 8, 2005, Brian Peay and his wife, Lori Peay, executed a purchase agreement with American Dream Housing, Inc., for the purchase of a SEHI manufactured home. The agreement provided:

> This agreement contains the entire understanding between dealer and buyer and no other representations or inducements, verbal or written, have been made which are not contained in this contract.

The purchase agreement did not reference a separate agreement and did not contain an arbitration clause.

On January 30, 2006, SEHI delivered the manufactured home from its place of business in Alabama to Owensboro, Kentucky, to American Dream, which later delivered the home to the Peays. Pursuant to a contract with the Peays, Jerry Morris Construction placed the home over its foundation and Larry Hayden performed plumbing work.

On June 26, 2006, over seven months after the Peays executed the purchase agreement for the home, the purchase closed. In addition to signing the final sales agreement, Brian Peay received a warranty book from SEHI and signed an attached agreement entitled "Binding Arbitration Agreement and Jury Waiver." The warranty book was signed by Brian Peay, representatives of SEHI and American Dream but was not signed by Lori Peay.

The warranty book included the following clause:

> You and We agree to arbitrate any and all claims and disputes arising from or relating to the Contract, the Manufactured Home, the sale of the Manufactured Home, the design and construction of the Manufactured Home, the financing of the Manufactured Home, and any and all other disputes between You and Us, including any disputes regarding the enforceability, interpretation, breadth, scope and meaning of this Agreement. The arbitration will be binding. You and We further agree to waive any right to trial by jury in any civil action arising from or relating to the Contract, the Manufactured Home, the sale of the Manufactured Home, the design and construction of the Manufactured Home, the financing of the Manufactured Home and any and all other disputes between You and Us.

Brian and Lori subsequently received warranty service from SEHI.

On October 3, 2008, Brian and Lori filed a complaint alleging breach of warranty and demanding monetary damages in the Daviess Circuit Court against American Dream, Jerry Morris Construction, Larry Hayden and SEHI. SEHI subsequently filed a motion to compel arbitration of all claims filed against it pursuant to the arbitration clause.

Following a hearing, the trial court denied arbitration. The trial court concluded: (1) the integration clause in the earlier purchase agreement between the Peays and American Dream precluded any subsequent agreements; (2) there was no privity of contract between the Peays and SEHI and no consideration for any contract; and (3) the arbitration agreement was unconscionable. SEHI appealed pursuant to KRS 417.220(1)(a), which permits an appeal from an order denying an application to compel arbitration.[1] The issue is whether the Peays

[1] Only SEHI and the Peays are parties to this appeal.

waived their right to seek redress in the courts by signing the warranty book at the time of closing.

In 1984, Kentucky adopted the Uniform Arbitration Act (KUAA), which permits arbitration agreements. KRS 417.050 reads in part:

> A written agreement to submit any existing controversy to arbitration or a provision in written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law for the revocation of any contract.

KRS 417.060(1) provides:

> On application of a party showing an agreement described in KRS 417.050, and the opposing party's refusal to arbitrate, the court shall order the parties to proceed with arbitration. If the opposing party denies the existence of the agreement to arbitrate, the court shall proceed summarily to the determination of the issue so raised. The court shall order arbitration if found for the moving party; otherwise, the application shall be denied.

Consistent with the General Assembly's directive, our courts have consistently expressed that arbitration is favored. *See e.g., Mortgage Electronic Registration Systems, Inc. v. Abner*, 260 S.W.3d 351, 353 (Ky.App. 2008). However, an arbitration clause remains subject to the general rules of contract and cannot escape judicial scrutiny.

Preserving the litigant's right to seek judicial redress, KRS 417.050 contains a saving clause: It provides that arbitration may be avoided "upon such grounds as exist at law for the revocation of any contract." As a threshold matter,

whether an arbitration clause is enforceable is to be resolved by the trial court based on fundamental principles of contract law and jurisprudence and is subject to appellate *de novo* review. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 115 S.Ct. 1920, 131 L.Ed.2d 985 (1995).

A basic premise of jurisprudence is that an unconscionable agreement is unenforceable. *Conseco Finance Servicing Corp. v. Wilder*, 47 S.W.3d 335 (Ky.App. 2001). Courts must assess whether an arbitration clause is enforceable on a case-by-case basis to determine if it is abusive or unfair. *Id*. at 342. Heightened scrutiny is required where, as here, the arbitration clause is contained in an agreement involving parties of unequal bargaining power.

A concise definition of an adhesion contract was provided in *Conseco,* "[A] standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." *Id*. at 342. Restated, contracts of adhesion are offered to the consumer on "essentially a 'take it or leave it' basis without affording the consumer a realistic opportunity to bargain." *Jones v. Bituminous Cas. Corp.,* 821 S.W.2d 798, 801 (Ky. 1991). An adhesion contract that is procedurally unconscionable will not be enforced against a consumer. Factors to be considered when determining unconscionability include the parties' bargaining power, the clarity of the contract language, the oppressiveness of the terms, and presence or absence of a meaningful choice. *Jenkins v. First American Cash Advance of Georgia*, *LLC*, 400 F.3d 868, 875-876 (11th Cir. 2005). After

considering the totality of the circumstances in the case presented, we conclude that the arbitration agreement is unconscionable.

Unlike the purchasers in *Conseco,* where the arbitration provision was contained in the sales contract, the arbitration provision was not presented to the Peays until the closing and was presented by the manufacturer, not the seller. The purchase contract with American Dream was executed eight months prior to the signing of the SEHI warranty book. The purchase agreement excluded all other documents; yet, the SEHI warranty book contained an arbitration clause. When confronted with SEHI's warranty conditions at the closing, the Peays were already contractually bound by the purchase contract and in the unenviable "take it or leave it" position.

Presented with a similar fact situation, the Louisiana Supreme Court summarized the consumer's predicament:

> The parties had already agreed upon the terms of contract of sale before closing, and binding arbitration was not one of them. According to the original purchase agreement's terms, title of the mobile home passed to the Rodriguezes once they paid for the mobile home, either through cash or financing. Contrary to what they were told, they did not need to sign the arbitration agreement to take delivery of their home.

Rodriguez v. Ed's Mobile Homes Of Bossier City, La., 889 So.2d 461, 464 (La.App. 3 Cir. 2004). We are equally persuaded that the Peays cannot be bound by the arbitration clause explicitly excluded by the purchase contract and presented only moments before the closing.

We conclude that the clause sought to be enforced is unconscionable. However, because arbitration clauses are increasingly prevalent in consumer contracts, we comment on the absence of Lori's signature on the document which SEHI seeks to enforce against her. As a matter of general contract law, Lori cannot be legally bound by an agreement to which she did not consent. *See Ally Cat, LLC v. Chauvin*, 274 S.W.3d 451 (Ky. 2009) (holding that assent to be bound by the terms of an agreement must be expressed and simple acknowledgment of the receipt of the document is insufficient). Thus, enforcement of the arbitration clause in the warranty book would result in piecemeal litigation and defeat judicial economy because Lori's claims against American Dream and the remaining defendants remain pending in the Daviess Circuit Court.

Based on the foregoing, the order of the Daviess Circuit Court is affirmed.

CAPERTON, JUDGE, CONCURS.

NICKELL, JUDGE, DISSENTS BY SEPARATE OPINION.

NICKELL, JUDGE, DISSENTING: Respectfully, I dissent. I believe the majority has disregarded two of SEHI's arguments on appeal and has inaccurately concluded that the arbitration agreement was unconscionable.

SEHI argues the trial court erred by finding: (1) the terms of the prior purchase agreement precluded the subsequent arbitration agreement; (2) there was no privity of contract and no consideration to support the arbitration agreement; and (3) the arbitration agreement was unconscionable. The majority bases its

ruling solely on its perception that the agreement was unconscionable. I disagree with this conclusion and further believe SEHI is correct in its other claims of error. Thus, I would reverse and remand.

Brian Peay signed the final sales agreement for the home at the closing on June 26, 2006. At the closing, Peay received a warranty book from SEHI and signed an agreement attached to the warranty book entitled "Binding Arbitration Agreement and Jury Waiver" wherein Peay and SEHI agreed to submit any and all disputes to arbitration. The arbitration agreement was signed by Brian Peay, and representatives of both SEHI and American Dream. Peay was shown a closing video which further explained the arbitration agreement. The Peays subsequently sought and received warranty service from SEHI on two occasions after closing, including work performed on or about November 6, 2006, and November 22, 2006.

KRS 417.050 states, in pertinent part:

> A written agreement to submit any existing controversy to arbitration or a provision in written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law for the revocation of any contract.

In *American General Home Equity, Inc. v. Kestel*, 253 S.W.3d 543, 550 (Ky. 2008), the Supreme Court of Kentucky stated:

> Whether state or federal law governs makes little practical difference, however, because the Kentucky Uniform Arbitration Act (KUAA) contained in Kentucky Revised Statutes (KRS) Chapter 417 is similar to and has

> been construed consistently with the FAA. Furthermore, both the FAA and KUAA state that arbitration agreements must be enforced unless valid grounds for revoking any contract are established.

"Naturally, as contract law is generally established as a matter of state law, state law governing contracts comes into play even when applying the FAA." *Id.* at fn. 14 (citing *Perry v. Thomas*, 482 U.S. 483, 492 n. 9, 107 S.Ct. 2520, 96 L.Ed.2d 426 (1987)). Arbitration agreements are reviewed under the principles of contract law. *Mortgage Electronic Registration Systems, Inc. v. Abner*, 260 S.W.3d 351, 353 (Ky.App. 2008). On appeal, this Court reviews the denial of a motion to compel arbitration under the *de novo* standard, except that findings of fact are reviewed for clear error only. *Conseco Finance Servicing Corp. v. Wilder*, 47 S.W.3d 335, 340 (Ky.App. 2001). Kentucky law favors arbitration agreements. *Kodak Mining Company v. Carrs Fork Corporation*, 669 S.W.2d 917 (Ky. 1984).

First, I do not believe the integration clause contained in the purchase agreement executed between the Peays and American Dream precluded the later execution of the arbitration agreement. The integration clause states:

> This agreement contains the entire understanding between *dealer and buyer* and no other representations or inducements; verbal or written have been made which is not contained in this contract.

(Emphasis added). The dealer was American Dream. The Peays concede SEHI was not a party to the purchase agreement. I find nothing in the language of the integration clause, which would prevent the Peays from entering into a subsequent and separate arbitration agreement with a different party concerning the modular

home. The trial court did not cite any authority to support its conclusion that an integration clause binds a party thereto from entering into a subsequent and separate agreement with a non-party, nor could I find any. Moreover, the subsequent arbitration agreement executed between the Peays and SEHI did not vary the terms of the purchase agreement executed between the Peays and American Dream. It does not appear that the Peays were compelled to enter into the subsequent arbitration agreement with SEHI. In the somewhat analogous context of the merger doctrine,[2] this Court has held that arbitration agreements are collateral to the transfer of property and, thus, are not extinguished or superseded by a deed. *Drees, Co. v. Osburg*, 144 S.W.3d 831, 833 (Ky.App. 2003). I conclude the same reasoning applies to the present case where the arbitration agreement was entered into with a non-party subsequent to an earlier purchase agreement.

Second, I believe there was privity of contract and sufficient consideration for the contract between the Peays and SEHI. In *Presnell Const. Managers, Inc. v. EH Const LLC.,* 134 S.W.3d 575, 579 (Ky. 2004), the Supreme Court of Kentucky stated:

> "Privity of contract" is "[t]he relationship between parties to a contract, allowing them to sue each other but preventing a third party from doing so." Thus, "[o]rdinarily, the obligations arising out of a contract are due only to those with whom it is made; a contract cannot be enforced by a person who is not a party to it or in

[2] Under the merger doctrine, upon delivery and acceptance of a deed, the deed extinguishes or supersedes the provisions of the underlying contract for the conveyance of the realty.

> privity with it, except under a real party in interest statute or, under certain circumstances, by a third-party beneficiary." Consequently, "[a]s a general rule, whenever a wrong is founded upon a breach of contract, the plaintiff suing in respect thereof must be a party or privy to the contract, and none but a party to a contract has the right to recover damages for its breach against any of the parties thereto."

(Internal citations omitted).

The general requirements for a valid and enforceable contract are "offer and acceptance, full and complete terms, and consideration." *Cantrell Supply, Inc. v. Liberty Mut. Ins*. Co., 94 S.W.3d 381, 384 (Ky.App. 2002). Consideration has been defined as a benefit conferred to a promisor or a detriment incurred by a promisee. *Huff Contracting v. Sark*, 12 S.W.3d 704, 707 (Ky.App. 2000).

Brian Peay and the general manager of SEHI both signed the arbitration agreement, which was captioned "**Binding Arbitration Agreement and Jury Waiver**." (Emphasis in original). Peay also acknowledged watching a video explaining the arbitration agreement and the factory warranty he received. Peay signed a written script of the video acknowledging that he understood its contents. In exchange for executing the arbitration agreement, the Peays received an express warranty, which they availed themselves of on two occasions, November 6, 2006, and November 22, 2006. Further, even if it could be argued that the receipt and exercise of the express warranty was not a condition of the arbitration agreement, "an arbitration clause requiring both parties to submit

equally to arbitration constitutes adequate consideration." *Kruse v. AFLAC Intern., Inc.*, 458 F.Supp.2d 375, 385 (E.D. Ky. 2006). Mutual promises are a valid form of consideration as long as there is some benefit to the promisor or detriment to the promisee. *More v. Carnes*, 309 Ky. 41, 56, 214 S.W.2d 984, 991 (1948). Therefore, I believe there was a valid agreement to arbitrate, which was supported by sufficient consideration.

Third, I believe the majority is incorrect in concluding the arbitration agreement unconscionable. In *Valued Services of Kentucky, LLC v. Watkins*, 309 S.W.3d 256, 260 (Ky.App. 2009), this Court discussed unconscionability in the context of arbitration agreements as follows:

> It is a fundamental rule of contract law that, "absent fraud in the inducement, a written agreement duly executed by the party to be held, who had an opportunity to read it, will be enforced according to its terms." A narrow exception to this rule is the doctrine of unconscionability, which is used by the courts to police the excesses of certain parties who abuse their right to contract freely. It is directed against one-sided, oppressive and unfairly surprising contracts, and not against the consequences per se of uneven bargaining power or even a simple old-fashioned bad bargain.
>
> An unconscionable contract has been characterized as one which no man in his senses, not under delusion, would make, on the one hand, and which no fair and honest man would accept, on the other. Unconscionability determinations being inherently fact-sensitive, courts must address such claims on a case-by-case basis.

(Internal citations omitted). Here the trial court relied solely on the unpublished case, *Paul Miller Ford v. Rutherford*, 2007-CA-000293-MR (December 28, 2007),

review denied, (November 19, 2008), in determining the arbitration agreement was unconscionable. The majority rests its decision on its belief the arbitration clause was specifically excluded by the integration clause contained in the purchase contract. I cannot agree.

This is not a case where any fraud or misleading conduct has been alleged. The Peays simply deny their obligation under the arbitration agreement. The arbitration agreement was boldly labeled and set out the terms in plain language. Peay viewed a video further explaining the arbitration agreement and signed a written script of the video acknowledging that he had viewed the video and understood its contents. It is also important to note that the arbitration agreement covers only the claims against SEHI. American Dream and the other defendants below did not seek to take advantage of this agreement and the claims against them are still pending in the Daviess Circuit Court. Based upon the undisputed circumstances of this case, I cannot agree with the majority's affirmation of the trial court's holding that the arbitration agreement executed between the Peays and SEHI was unconscionable, particularly since it was supported by both privity of contract and consideration, and because the Peays sought and were provided warranty service by SEHI on at least two occasions.

Finally, I believe it important to note that Lori Peay signed neither the purchase agreement nor the arbitration agreement. The majority seems to cast aspersions upon SEHI for seeking to enforce the arbitration agreement against a non-signatory, holding Lori Peay cannot be bound to an agreement to which she

did not consent. However, in a twist of logic, the majority gives her the benefit of the merger clause contained in the purchase agreement—another agreement to which she cannot be said to have consented in light of her failure to join in the execution. Taking its reasoning to its logical conclusion, the majority is sanctioning the Peay's desire to "have their cake and eat it too." I believe such a result is contrary to the letter and spirit of the law and such an interpretation is flawed. If Lori Peay cannot be bound by the arbitration agreement because she did not execute it with her husband, it follows that she cannot benefit from the purchase agreement for the same reason. Under the majority's analysis, because she failed to execute any of the documents in question, it becomes doubtful that Lori Peay has standing to prosecute any claims relating to the purchase of the modular home.

For the reasons stated, I would reverse and remand this matter to the trial court with directions to enter an order compelling arbitration.

BRIEFS FOR APPELLANT:

Elizabeth A. Deener
Larry C. Deener
Lexington, Kentucky

BRIEF FOR APPELLEE:

Zack N. Womack
Henderson, Kentucky