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UNFAIR AND DECEPTIVE TRADE PRACTICES IN CONSTRUCTION LITIGATION AND ARBITRATION

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I. INTRODUCTION

In suits arising out of construction disputes plaintiffs may assert claims for unfair and deceptive trade practices with an eye toward collecting attorneys' fees and increasing leverage during settlement negotiations. Defendants subsequently defend the claim or pursue the costly process of attempting to have such claims dismissed on motions for summary judgment. This article will provide guidance for determining whether or not facts in a particular construction dispute support a claim for an unfair or deceptive trade practice. The analysis will focus on disputes arising out of commercial, institutional, and industrial construction and on situations involving: (1) subcontractor versus general contractor or construction manager and (2) general contractor or homeowners' association versus owner-developer.

The legal theory of a lawsuit arising in a construction dispute typically is either breach of contract or breach of the implied warranty of habitability. In some situations, however, the theory will sound in tort, such as when there is no contract between the prime contractor and the construction manager who is providing services as the owner's agent. As a part of a breach of contract claim, the contractor usually alleges both that the work was performed in accordance with the drawings and specifications and that payment is due. The owner or developer usually

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responds by claiming that the work in fact was not performed in accordance with drawings and specifications and that, therefore, payment is not due. In some situations, no dispute arises over whether the owner owes retainage upon final payment, however. The contractor, however, might claim damages for delay or acceleration. In response, owners facing such claims may refuse to pay retainage at final payment unless the contractor releases its claim. The homeowners' association may be faced with a condominium whose roof leaks, whose foundation is cracking, and whose parking lot is sliding down a mountain. All of these situations may spawn thoughts of overpowering the opposition with demands for treble damages and attorneys' fees.

This article examines case law interpreting the North Carolina and South Carolina unfair trade practices statutes for common elements in the courts' reasoning. Also, since construction disputes frequently are resolved through arbitration, the article will examine the arbitrator's right to award treble damages and attorney's fees under the "all disputes" clause contained in many standard form construction agreements.

II. THE STATUTORY PREDICATE FOR UNFAIR TRADE PRACTICE CLAIMS IN CONSTRUCTION LITIGATION

Rights and remedies arising out of unfair or deceptive trade practices are not based upon common-law precedents and exist only as provided in statutes. These creatures of statutes are *sui generis*, apparently sounding in tort but neither wholly tortious nor wholly contractual in nature.¹

The starting point in any study of this developing area of the law is the 1914 Federal Trade Commission Act (FTCA).² The key language and core concepts of "unfairness," "deception," and methods of "competition" and their relationships with "commerce" or "business" are found in title 15, section 45(a)(1) of the United States Code as follows: "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce are declared

1. See *Bernard v. Central Carolina Truck Sales*, 68 N.C. App. 228, 230, 314 S.E.2d 582, 584 (1984) (quoting *Slaney v. Westwood Auto, Inc.*, 366 Mass. 688, 704, 322 N.E.2d 768, 779 (1975)).

2. 15 U.S.C.A. §§ 41-58 (West 1982 & Supp. 1988).

unlawful.”³

The North Carolina Unfair Trade Practices Act (NCUTPA) uses identical language.⁴ The South Carolina Unfair Trade Practices Act (SCUTPA)⁵ uses slightly different language, but retains essentially the same meaning: “(a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.”⁶ North Carolina courts have followed federal precedents in the application of state law to causes of action under the NCUTPA.⁷ The South Carolina legislature specifically mandated the same result by expressing in the SCUTPA that the courts be “guided” by interpretations of the federal act in construing state law.

The FTCA does not create a private right of action for individual litigants for acts declared unlawful under section 45(a).⁸ The federal courts, however, will protect an individual’s rights and enforce appropriate remedies under state laws if they have diversity jurisdiction. The FTC encourages state adoption of legislation similar to the UTPA, which are commonly called “Little FTC Acts” since they are identical to section 5 of the FTC Act, because it does not have available resources to police unfair acts or practices.⁹ These state acts compliment the FTCA for consumer protection in construction contract disputes. State acts provide private causes of action for abusive commercial practices at the local level, referring to the federal act for guidance.¹⁰

Both SCUTPA and NCUTPA allow private rights of action with the possibility of treble damages¹¹ and attorneys’ fees.¹²

3. 15 U.S.C.A. § 45(a)(1) (West Supp. 1988).

4. See N.C. GEN. STAT. § 75-1.1(a) (1988).

5. S.C. CODE ANN. §§ 39-5-10 to -160 (Law. Co-op. 1976). For an excellent analysis of SCUTPA, see Day, *The South Carolina Unfair Trade Practices Act: Sleeping Giant or Illusive Panacea?*, 33 S.C.L. REV. 479 (1982); see also Norton, *The South Carolina Unfair Trade Practices Act and the Void-For-Vagueness Doctrine*, 40 S.C.L. REV. 641 (1989).

6. S.C. CODE ANN. § 39-5-20(a) (Law. Co-op. 1976).

7. See *Lindner v. Durham Hosiery Mills*, 761 F.2d 162 (4th Cir. 1985); *Johnson v. Phoenix Mut. Life Ins. Co.*, 300 N.C. 247, 266 S.E.2d 610 (1980).

8. See *Fulton v. Hecht*, 580 F.2d 1243 (5th Cir. 1978), cert. denied, 440 U.S. 981 (1979); *Holloway v. Bristol-Myers Corp.*, 485 F.2d 986 (D.C. Cir. 1973).

9. See Day, *supra* note 5, at 509.

10. See Norton, *supra* note 5, at 641.

11. The South Carolina Code provides:

Any person who suffers any ascertainable loss of money or property . . . as a result of the use or employment by another person of an unfair or deceptive

Both statutes have sections excepting and prohibiting specified acts¹³ and, like the FTCA, establish consumer protection schemes within the authority of their attorneys general.¹⁴

Civil litigation seems to be cyclic. The tidal wave of RICO¹⁵ litigation is one example. Similarly, plaintiff's attorneys have discovered that claims in construction litigation based on unfair and deceptive trade practices offer a new and useful approach, with a possible bonus of attorneys' fees.

In some situations within the construction industry, the elements necessary to establish violations of SCUTPA and NCUTPA are satisfied by proof of deception, unfair and dishonest business conduct, and fraudulent construction practices.¹⁶

method, act or practice . . . may bring an action individually, . . . to recover actual damages. If the court finds that the use or employment of the unfair or deceptive method, act or practice was a willful or knowing violation . . . the court shall award three times the actual damages sustained

S.C. CODE ANN. § 39-5-140(a) (Law. Co-op. 1976) (emphasis added).

The North Carolina Code provides:

If *any person* shall be injured or the business of any person, firm or corporation . . . destroyed or injured by reason of any act or thing done by any other person, firm or corporation in violation . . . of this Chapter, such person, firm or corporation so injured shall have a right of action [for] . . . such injury done, and if damages are assessed . . . judgment shall be rendered . . . for treble the amount fixed by the verdict.

N.C. GEN. STAT. § 75.16 (1988) (emphasis added).

Note that SCUTPA allows treble damages only for a "willful or knowing" violation, but NCUTPA automatically allows any damages assessed to be tripled.

12. Section 39-5-140(a) of the South Carolina Code allows the payment of reasonable attorneys' fees for any individual who prevails in his SCUTPA private cause of action. *See* S.C. CODE ANN. § 39-5-140(a) (Law. Co-op. 1976). In North Carolina the trial judge awards attorneys' fees, at his discretion, "upon a finding . . . that the party charged . . . willfully engaged in the [unfair] act or [deceptive] practice, and . . . refus[ed] . . . to fully resolve the matter." N.C. GEN. STAT. § 75.16.1 (1988). Also, the defendant may receive attorneys' fees if the plaintiff "knew, or should have known, the action was frivolous and malicious." *See id.*

13. *See, e.g.*, N.C. GEN. STAT. §§ 75.1.1(a), (c); -5(b); -30 (1988) (respectively dealing with general unfair and deceptive practices, specific exemptions, sale and business activities, and automatic phone solicitation machines); S.C. CODE ANN. §§ 39-5-20, -30, -35, -40 (Law. Co-op. 1976) (respectively dealing with general unfair and deceptive practices, pyramid clubs, certain insurance coverage, and specific exemptions).

14. *See* N.C. GEN. STAT. §§ 75-13 to -15 (1988); S.C. CODE ANN. §§ 39-5-60 to -80 (Law. Co-op. 1976).

15. 18 U.S.C. §§ 1961-1968 (1982 & Supp. 1988) (Racketeer Influenced and Corrupt Organizations Act).

16. N.C. GEN. STAT. § 5-1.1(b) (1988) defines "commerce" to include "all business activities, however denominated." SCUTPA makes unlawful "unfair methods of competition" and unfair or deceptive practices in *any trade or commerce.*" (Emphasis added.)

For example, if a dishonest contractor deceives and defrauds a first-time home builder as a result of unfair practices, the home builder, who is essentially a consumer, rightfully has an unfair trade practice cause of action and the protection of the attorney general's consumer affairs staff.¹⁷

At the other end of the spectrum, however, suppose a power company and a major construction company contract to build a multimillion dollar power plant, and the project ends in a dispute in which "unfairness" is alleged in a breach of contract action. Should the power company obtain treble damages under the state unfair trade practices act? Within commercial contents, the concept of "unfairness" is difficult to grasp. As Judge Haynsworth wrote in 1981: "In a sense, unfairness inheres in every breach of contract when one of the contracting parties is denied the advantage for which he contracted, but this is why remedial damages are awarded on contract claims."¹⁸ Formulating precise definitions of acts or practices that are declared unlawful in the UTPA statutes is impossible. Courts must look to the facts in each transaction and their impact upon the marketplace.

III. NORTH AND SOUTH CAROLINA CASE LAW

Courts have decided only a handful of cases involving construction-related disputes that include a claim for unfair trade practices under SCUTPA or NCUTPA. Of those cases, very few discuss the merits of the claim, and none are truly borderline cases. Of course, each time a court broaches these issues, it gives some clue as to the position the court will take in closer factual situations. Whether a trade or practice is unfair or deceptive depends on the facts of each case and the impact the practice has on the market.¹⁹ Following its model, section 5(a)(1) of the

See S.C. CODE ANN. § 39-5-20 (Law. Co-op. 1976); see also *Pinehurst, Inc. v. O'Leary Bros. Realty, Inc.*, 79 N.C. App. 51, 338 S.E.2d 918, cert. denied, 316 N.C. 378, 342 S.E.2d 896 (1986); *Stone v. Paradise Park Homes, Inc.*, 37 N.C. App. 97, 245 S.E.2d 801 (1978); *Payne v. Holiday Towers, Inc.*, 283 S.C. 210, 321 S.E.2d 179 (Ct. App. 1984).

17. Cf. *Lindner v. Durham Hosiery Mills, Inc.*, 761 F.2d 162 (4th Cir. 1985) (a purpose of unfair trade practice laws is to protect the consuming public).

18. *United Roasters, Inc. v. Colgate-Palmolive Co.*, 649 F.2d 985, 992 (4th Cir. 1981).

19. See *Marshall v. Miller*, 302 N.C. 539, 548, 276 S.E.2d 397, 403 (1981).

FTCA, courts have interpreted SCUTPA to require that a deceptive practice have “the capacity or effect or tendency to deceive.”²⁰ Actual intent to deceive, however, is not a prerequisite.²¹ The following cases explain the application of the SCUTPA to construction disputes:

(1) Subdivision lot sales agents and the developer as a principal violated SCUTPA when the agents told prospective buyers whatever they felt the buyers wished to hear,²² including illusory promises to pave roads, add street lights, and access city water.²³ The court held that the misrepresentations, which were made by the agent and the developer as a principal, were unfair and deceptive practices.²⁴

(2) An experienced contractor violated SCUTPA by fraudulently inducing inexperienced homeowners into entering a contract for repairs and into giving the contractor a promissory note and a mortgage on their home. The court held that the contractor, as well as the assignee of the note and mortgage, were liable under SCUTPA.²⁵

(3) The contractor and suppliers of fiberglass glazing material for a greenhouse did not violate SCUTPA by misrepresenting the extent of the material’s warranty. The court held that the misrepresentation constituted a breach of contract accompanied by a fraudulent act, but was *not* an unfair trade practice²⁶. Other cases mentioned claims of unfair trade practice, but did not analyze the merits of the claim in any detail.²⁷ Thus, there are few tested fact situations under SCUTPA.

North Carolina courts apply a factor analysis to determine whether a claim for unfair trade practices is sufficient. First, there must be a practice, act, or representation that falls within

20. *State ex rel. McLeod v. C & L Corp.*, 280 S.C. 519, 525, 313 S.E.2d 334, 338 (Ct. App. 1984).

21. *See id.* at 524, 313 S.E.2d at 337.

22. *See id.* at 523-25, 535, 313 S.E.2d at 336-38, 342.

23. *Id.* at 523, 313 S.E.2d at 337.

24. *See id.* at 523-24, 313 S.E.2d at 337-38.

25. *See Rosemond v. Campbell*, 288 S.C. 516, 343 S.E.2d 641 (Ct. App. 1986).

26. *See Hines v. IBG Int’l, Inc.*, 813 F.2d 1331 (4th Cir. 1987).

27. *See, e.g., Dockside Ass’n v. Detyens, Simmons and Carlisle*, 285 S.C. 565, 330 S.E.2d 537 (Ct. App. 1985); *Reid v. Harbison Dev. Corp.*, 285 S.C. 557, 330 S.E.2d 532 (Ct. App. 1985); *Payne v. Holiday Towers, Inc.*, 283 S.C. 210, 321 S.E.2d 179 (Ct. App. 1984).

the definition of “unfair.”²⁸ The courts generally have described a practice as unfair “when it offends established public policy as well as when the practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers.”²⁹ Second, North Carolina requires that the acts or practices have an impact on the marketplace. Usually an act has an impact on the marketplace either when it was part of a larger pattern or when the act was so strongly against public policy that a court’s failure to redress the behavior would threaten consumers in general.³⁰ Third, North Carolina courts require that the acts or practices have an “adverse impact on the individual or entity deceived” in the form of actual damages.³¹

Considering these three factors, North Carolina courts have found a violation of NCUTPA in the following situations:

(1) when a builder constructed a house on land filled with vegetable material including tress, pine needles, and pine cones;³²

(2) when an aluminum siding contractor made a cancellable contract with a homeowner, but then would not provide the forms with which to cancel;³³ and

(3) when a homeowner routinely secured services and materials from small subcontractors with no intention of paying them.³⁴

North Carolina courts have found the following circumstances were *not* violative of NCUTPA:

(1) when an architect agreed to design a house that would cost \$35,000 and to follow certain specifications, but submitted plans for houses of lesser quality costing \$40,000 and \$47,000;³⁵

(2) when a developer failed to fix a home purchaser’s water

28. See *Jennings Glass Co. v. Brummer*, 88 N.C. App. 44, 362 S.E.2d 578 (1987).

29. *Id.* at 52, 362 S.E.2d at 584 (quoting *Johnson v. Phoenix Mut. Life Ins. Co.*, 300 N.C. 247, 263, 263 S.E.2d 610, 621 (1980)).

30. See *Johnson v. Phoenix Mutual Life Ins. Co.*, 300 N.C. 247, 263 S.E.2d 610 (1980).

31. See *Miller v. Ensley*, 88 N.C. App. 686, 691, 365 S.E.2d 11, 14 (1988).

32. See *Stone v. Paradise Park Homes, Inc.*, 37 N.C. App. 97, 245 S.E.2d 801 (1978).

33. See *Eastern Roofing & Aluminum Co. v. Brock*, 70 N.C. App. 431, 320 S.E.2d 22 (1984).

34. See *Jennings Glass Co. v. Brummer*, 88 N.C. App. 44, 362 S.E.2d 578 (1987).

35. See *Hammers v. Lowe’s Co.*, 48 N.C. App. 150, 268 S.E.2d 257 (1980).

drainage problem that clearly was covered by warranty;³⁶

(3) when roofing materials used on a tobacco warehouse failed and clearly were covered by the supplier's warranty;³⁷

(4) when a contractor requested early progress payments to repair equipment for constructing a pond and then stopped work after receiving the payment;³⁸

(5) when a retired couple, in reliance on developer's assurance that the lot they intended to purchase would be served with water, sewer, paved roads, and would be ready for construction of their retirement home, moved to North Carolina and expended all of their savings;³⁹

(6) when a contractor was induced to enter a contract with a person representing himself as the owner, who was, in fact, the previous owner who had transferred the property to his daughter;⁴⁰ and

(7) when a contractor stated that the use of beetle-infested beams would cause the owner no problems other than "a little bit of sawdust."⁴¹

These North Carolina cases indicate that a mere breach of warranty or contract is insufficient to establish a claim for an unfair trade practice.⁴² The alleged "unfair" practice must be repeated or be very strongly against public policy.⁴³

The North Carolina position is in accord with the prevailing view across the country.⁴⁴ *Gross v. Idea Pool Corp.*⁴⁵ explains the reasoning. In *Gross* the Georgia Court of Appeals stated that the Fair Business Practices Act,⁴⁶ also modeled on the FTCA, does not make every breach of contract a violation. A breach of contract will constitute a violation only if a deceptive act or practice

36. See *Coble v. Richardson Corp.*, 71 N.C. App. 511, 322 S.E.2d 817 (1984).

37. See *Warren v. Guttanit, Inc.*, 69 N.C. App. 103, 317 S.E.2d 5 (1984).

38. See *Goodrich v. Rice*, 75 N.C. App. 530, 331 S.E.2d 195 (1985).

39. See *Opsahl v. Pinehurst, Inc.*, 81 N.C. App. 56, 344 S.E.2d 68 (1986).

40. See *Miller v. Ensley*, 88 N.C. App. 686, 365 S.E.2d 11 (1988).

41. See *Warfield v. Hicks*, 91 N.C. App. 1, 370 S.E.2d 689 (1988).

42. Also, in South Carolina a mere breach of contract is not a SCUTPA violation. See *Key Co. v. Fameco Distrib.*, 292 S.C. 524, 357 S.E.2d 476 (Ct. App. 1987); see also *Business Law, Annual Survey of South Carolina Law*, 40 S.C.L. Rev. 22 (1988).

43. See *supra* notes 28-43 and accompanying text.

44. See *Owl Constr. Co. v. Ronald Adams Contractor, Inc.*, 642 F. Supp. 475 (E.D. La. 1986); *Rosa v. Johnson*, 3 Haw. App. 420, 651 P.2d 1228 (1982); *Eastlake Constr. Co. v. Hess*, 102 Wash. 2d 30, 686 P.2d 465 (1984).

45. 181 Ga. App. 483, 352 S.E.2d 806 (1987).

46. GA. CODE ANN. §§ 10-1-390 to -407 (1982 & Supp. 1988).

is present, either against multiple consumers or against an individual. For individuals to have standing to bring a claim, they must be a member of the consuming public, suffer damage as the result of an unfair or deceptive act or practice, and, further, the act or practice must have a potentially harmful effect on the general consuming public or a significant portion thereof.⁴⁷

IV. ARBITRATOR'S POWER TO AWARD UNFAIR TRADE PRACTICE STATUTORY REMEDIES

SCUTPA and NCUTPA offer the additional remedies of treble damages and the possibility of attorneys' fees. Some argue that arbitrators also may award treble damages. The counter-argument is that punitive damages are a sanction that should be reserved for the state. New York courts have taken the latter position.⁴⁸ In *Garrity v. Lyle Stuart, Inc.*⁴⁹ the court reasoned that to give arbitrators such power would risk abuse of an arbitrators' discretion. The more popular view, however, is that when a legislature passes an arbitration act, it is expressing a strong state policy in favor of arbitration that should be limited only by other statutes.⁵⁰ Disputes about arbitrators' power to award attorneys' fees are less frequent. Both the North and South Carolina arbitration statutes include the same provision: "Unless otherwise provided in the agreement to arbitrate, the arbitrators' expenses and fees, together with other expenses, not including counsel fees, incurred in the conduct of the arbitration, shall be paid as provided in the award."⁵¹

In *G.L. Wilson Building Co. v. Thorneburg Hosiery Co.*⁵² the North Carolina Court of Appeals held that counsel fees are not a subject of arbitration under NCUTPA.⁵³ In *Thorneburg Hosiery* the contract provided that "[t]he Owner will pay reasonable attorney's fees incurred by the Contractor for the collec-

47. See 181 Ga. App. at 484, 352 S.E.2d at 808.

48. See, e.g., *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 356, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976).

49. 40 N.Y.2d 356, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976).

50. See *Arbitration, Survey of Developments in North Carolina Law*, 64 N.C.L. REV. 1145 (1986).

51. N.C. GEN. STAT. § 1-567.11 (1983); S.C. CODE ANN. § 15-48-110 (Law. Co-op. Supp. 1988).

52. 85 N.C. App. 684, 355 S.E.2d 815 (1987).

53. See *id.* at 689-90, 355 S.E.2d at 819.

tion of any defaulted payment due to the Contractor by the owner as a result of this contract.”⁵⁴ The court, reviewing the arbitration award, agreed that this contract clause was enforceable in court, but held that the arbitrators exceeded their authority by awarding attorneys’ fees. Thus, a separate action in court would be necessary to recover attorneys’ fees.⁵⁵

North Carolina, and possibly South Carolina, courts may take the opposite position on the issue of the arbitrability of a claim for treble damages. Of course, the contract between the parties must provide for the arbitration of such disputes. An “all disputes” clause⁵⁶ will indicate that the contract provides for the arbitration of unfair trade practices claims. If a contract contains this provision, the issue becomes the scope of the arbitrator’s authority to award damages. Neither the North Carolina nor the South Carolina arbitration statutes expressly provide for or prohibit the award of treble damages.⁵⁷ Thus, courts must weigh the policy in favor of arbitration against the policy of allowing only the courts to impose civil sanctions for undesirable behavior.

In *Rodgers Builders, Inc. v. McQueen*⁵⁸ the North Carolina Court of Appeals decided in favor of expanding the powers of the arbitrators.⁵⁹ In *McQueen* the contractor made a demand for arbitration and sought payments due from the owner. The arbitrator awarded contractual damages to the contractor, who then sought treble damages for unfair and deceptive trade practices in a separate trial. The *McQueen* court held that the unfair trade practices claim was arbitrable and that the arbitrator had the authority to award treble damages. Since the contractor could have pursued this claim in arbitration, the later unfair trade practices lawsuit was precluded by *res judicata*.⁶⁰

54. *Id.* at 687, 355 S.E.2d at 817.

55. *See id.* at 689-90, 355 S.E.2d at 819.

56. A typical “all disputes clause” was quoted in *Rodgers Builders, Inc. v. McQueens*, 76 N.C. App. 16, 331 S.E.2d 726 (1985): “All claims, disputes and other matters in question between the Contractor and the Owner arising out of, or relating to, the Contract Documents or breach thereof, . . . shall be decided by arbitration . . .” *Id.* at 18, 331 S.E.2d at 728.

57. *See* N.C. GEN. STAT. § 1-567.11 (1983); S.C. CODE ANN. § 15-48-110 (Law. Co-op. Supp. 1988).

58. 76 N.C. App. 16, 331 S.E.2d 726 (1985).

59. *See id.* at 29, 331 S.E.2d at 734.

60. *See id.* at 30, 331 S.E.2d at 735.

South Carolina courts have not faced this issue. Nevertheless, because South Carolina and North Carolina arbitration statutes are so similar, South Carolina courts also might permit arbitrators to award treble damages. Thus, in both South Carolina and North Carolina, the recovery of attorneys' fees likely is unavailable in arbitration, but treble damages may be recoverable under the Unfair Trade Practices Act.

V. CONCLUSION

In the proper factual scenario, SCUTPA and NCUTPA add two more arrows to the sling of claims that litigants in a construction dispute might allege. Practitioners, therefore, should advise their clients that an award of treble damages and attorneys' fees is a real possibility should a court uphold an unfair trade practices claim. Further, recovery of a treble damages award in arbitration is available in North Carolina and probably South Carolina, as well.

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