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Contract Law

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CONTRACT LAW

I. RIGHTS OF NEW HOME BUYERS CLARIFIED

In *Kennedy v. Columbia Lumber and Manufacturing Co.*¹ the South Carolina Supreme Court clarified the rights of new home buyers in South Carolina. The court apparently intended its holding to be a definitive statement on the rights of new home buyers. The *Kennedy* opinion is important for several reasons. First, the court stated, “The principles enunciated herein apply to all new residential construction, regardless of whether the purchaser obtains and holds legal title, *inter alia*: in his own name; in a corporate or partnership name; through a limited partnership; or by means of a horizontal property regime.”² Second, on the grounds that “this is the latest in a series of cases we have decided concerning theories of liability in new, residential housing,”³ the court used this case to reject the court of appeals’ discussion of the economic loss rule enunciated in *Carolina Winds Owners’ Association v. Joe Harden Builder, Inc.*⁴ Finally, the court dramatically reaffirmed the potential tort and warranty liability of South Carolina builders, but declined to extend such liability to lenders who do no more than lend money.

In 1976 Columbia Lumber and Manufacturing Company (Columbia Lumber) sold building materials on credit to Charles Crumpton, who did business as Rainbow Construction Company, to build a house for speculation. After Crumpton essentially completed the house, he experienced financial difficulties and was unable to pay his creditors, which included Columbia Lumber. Consequently, Crumpton deeded the property to his mother. Columbia Lumber filed a mechanic’s lien on the property for \$3,392.62, the amount Crumpton owed to Columbia Lumber. In lieu of foreclosing on the lien, however, Columbia Lumber accepted title to the house and repaid the lot and construction mortgages.⁵

On July 21, 1977, nine months after filing its lien and without recovering all of its losses from the original loan, Columbia Lumber sold the property to the plaintiff, John Kennedy. In 1983 Kennedy noticed

1. 299 S.C. 335, 384 S.E.2d 730 (1989).

2. *Id.* at 337 n.1, 384 S.E.2d at 732 n.1.

3. *Id.* at 341, 384 S.E.2d at 734.

4. 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988).

5. *Kennedy*, 299 S.C. at 338, 384 S.E.2d at 732-33.

a crack in the brick veneer on the rear of the house. Two years later, in 1985, he employed an engineer to estimate the cost to repair the crack. The engineer reported that a defective foundation had caused the crack. Thus, on September 27, 1985, Kennedy sued Columbia Lumber for negligence and breach of warranty. Kennedy later dropped the negligence claim.⁶

The supreme court found that the facts of *Kennedy* placed the case between the two earlier supreme court cases of *Lane v. Trenholm Building Co.*⁷ and *Roundtree Villas Association v. 4701 Kings Corp.*⁸ In *Lane* the court held that a lender, who was also the subdivision developer, was liable for the failure of a septic tank system under an implied warranty of habitability. The developer had taken title to the house from a builder who was in financial difficulty.⁹ In *Roundtree Villas Association* the court held that a lender who monitored the work of the builder was not liable in tort or under express or implied warranties for defective construction. The court held that the lender's monitoring of the builder was insufficient to establish a legal duty to prevent defects. The court also held that the lender was not a sufficient party to the sales of the units to be liable under a theory of implied warranty of habitability.¹⁰

Although the facts of *Kennedy* are similar to the facts in *Lane*, the *Kennedy* court found that the facts brought the case within *Roundtree Villas*, which rejected lender liability.¹¹ In *Lane* the court emphasized that "when a new building is sold there is an implied warranty of fitness . . . which springs from the sale itself."¹² In *Kennedy* Carolina Lumber sold the house to Kennedy.¹³ In both *Kennedy* and *Lane* the lenders acquired the homes from builders in financial difficulty, and both lenders were trying to salvage their investments. Both lenders chose to take possession of the house rather than foreclose on the lien.

Significant differences, however, exist between *Kennedy* and *Lane*. The most important difference is that the lender in *Lane* also developed the subdivision. In *Kennedy* the lender merely provided building materials to the builder. Second, in *Lane* the lender appears to have completed the construction of the house, while in *Kennedy* "Columbia Lumber did not participate in any way in the construction of the house

6. *Id.*, 384 S.E.2d at 733.

7. 267 S.C. 497, 229 S.E.2d 728 (1976).

8. 282 S.C. 415, 321 S.E.2d 46 (1984).

9. *Lane*, 267 S.C. at 500-03, 229 S.E.2d at 729-31.

10. *Roundtree Villas Ass'n*, 282 S.C. at 422-23, 321 S.E.2d at 50-51.

11. *Kennedy*, 299 S.C. at 338-41, 384 S.E.2d at 733-34.

12. 267 S.C. at 500, 229 S.E.2d at 729 (emphasis added).

13. 299 S.C. at 338, 384 S.E.2d at 733.

... .”¹⁴ Although the court did not mention it in the holding, a third difference is the length of time between the plaintiff’s purchase of the house and his initiation of legal action. In *Kennedy* the plaintiff owned the house eight years and two months before bringing suit.¹⁵ In *Lane* the plaintiff only owned the house for one year and four months.¹⁶

The *Lane* case, therefore, did not control the *Kennedy* decision and the court modified its rule about the relationship between the sale of a house and liability under an implied warranty of habitability. The court held “that a mere lender, even if a party to the sale, is ordinarily not liable under an implied warranty of habitability theory.”¹⁷ The court does, however, describe six situations in which a lender could be liable.¹⁸

The *Kennedy* opinion intentionally leaves open the question of what constitutes a reasonable time within which a buyer can assert his warranty claim.¹⁹ The case did not require the court to address Columbia Lumber’s argument that a lapse of over eight years was unreasonable.

The *Kennedy* court relied on the court of appeals’ decision in *Carolina Winds Owners’ Association v. Joe Harden Builder, Inc.*²⁰ and clarified and expanded the tort and warranty liability of residential builders. In *Carolina Winds Owners’ Association* owners of a condominium building sued, among others, the general contractor and the masonry subcontractor for construction deficiencies. Relying heavily on the supreme court’s opinions in *Lane v. Trenholm Building Co.*²¹ and *Arvai v. Shaw*²² the court of appeals held that (1) the defendant contractors were not liable under an implied warranty of habitability theory because they did not sell the building,²³ and (2) the plaintiffs could not recover in tort because of the economic loss rule.²⁴

In *Kennedy* the supreme court rejected both of these holdings.

14. *Id.*, 384 S.E.2d at 732.

15. *See id.*, 384 S.E.2d at 733.

16. *See* 267 S.C. at 500, 229 S.E.2d at 729.

17. *Kennedy*, 299 S.C. at 340, 384 S.E.2d at 734.

18. *Id.* at 340-41, 384 S.E.2d at 734 (lender liable if (1) it is also a developer, (2) it makes express representations, (3) it knowingly conceals a defect, (4) it is highly involved in the construction, (5) it cannot be distinguished from the developer, and (6) it forecloses on a developer during construction, takes title, is substantially involved in the construction, and sells the home).

19. *See id.* at 339 n.2, 384 S.E.2d at 733 n.2.

20. 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988).

21. 267 S.C. 497, 229 S.E.2d 728 (1976).

22. 289 S.C. 161, 345 S.E.2d 715 (1986).

23. *Carolina Winds Owners’ Ass’n*, 297 S.C. at 77-80, 374 S.E.2d at 899-901.

24. *Id.* at 82-89, 374 S.E.2d at 902-06.

The court held that, based on its opinion in *Hill v. Polar Pantries*,²⁵ an implied warranty of workmanlike service exists and . . . is distinct from the implied warranty of habitability.²⁶ The court, however, expanded the effect of this warranty of workmanlike service beyond the effect of the warranty in *Hill*. In *Hill* the court based the implied warranty on a contract theory and on a party's reliance on the other party's "hold[ing] himself out as specially qualified to perform work of a particular character."²⁷ In *Kennedy* the court broadly rejected any privity requirement for the operation of this, and perhaps any, implied warranty.²⁸

The supreme court also rejected the applicability of the economic loss rule in tort actions. The economic loss rule, which is traditionally used to distinguish actions in tort from those in contract, states that when purchased or repaired property is defective, no tort action exists unless the defect causes damage to something other than the purchased or repaired property.²⁹ Instead, the action is in contract.³⁰ The *Kennedy* opinion rejects this distinction because it focuses on consequences rather than on action. The court noted that a future inconsistency might exist. For example, a builder could be liable in tort because the buyer did not discover the negligence until the negligence injured a person or other property, while an equally blameworthy builder would not be liable in tort because the buyer discovered the negligence before any injury occurred.³¹

Under *Kennedy* actions apparently will lie in both tort and contract for most construction deficiencies. The court stated, however, that liability will be in contract if the only duty violated is contractual. The court's example is a home buyer who contracts for a blue room and the contractor paints the room brown.³² A failure to meet construction industry standards and building codes is a violation of a legal duty and, thus, is the basis for an action in tort.

The net effect of these significant changes is not clear. The court, however, has expanded home buyers' powers when purchasing residential property from builders. Furthermore, even more profound changes can be expected if the warranty of workmanlike service is expanded to cover other service contracts, and if the economic loss rule is inapplica-

25. 219 S.C. 263, 64 S.E.2d 885 (1951).

26. *Kennedy*, 299 S.C. at 344-45, 384 S.E.2d at 736.

27. 219 S.C. at 271, 64 S.E.2d at 888.

28. See 299 S.C. at 344, 384 S.E.2d at 736.

29. *Id.* at 341, 384 S.E.2d at 734.

30. See *id.* at 345, 384 S.E.2d at 736.

31. *Id.*, 384 S.E.2d at 737.

32. *Id.* at 347 n.3, 384 S.E.2d at 737 n.3.

ble in both product liability actions and actions based on other types of service contracts.

William R. Calhoun, Jr.

II. ARBITRATION AGREEMENT IN A CONSTRUCTION CONTRACT INCORPORATED BY REFERENCE INTO A SUBCONTRACT

In *Godwin v. Stanley Smith & Sons*³³ the South Carolina Court of Appeals held that an arbitration provision in a construction contract was incorporated by reference into a subcontract and, therefore, was binding on the subcontractor.³⁴ The court also held that the Federal Arbitration Act superseded the South Carolina Arbitration Act, and thus, the strict arbitration notice provisions of the South Carolina Arbitration Act did not apply.³⁵

Joey Godwin, a subcontractor doing business as Godwin Builders, entered into a contract with Stanley Smith & Sons (Smith) to hang wallpaper in two motel buildings that were under construction.³⁶ The parties called the agreement a "subcontract" and referenced the construction contract between Smith and the motel project's owner. The subcontract between Smith and Godwin did not expressly require arbitration, but the contract between Smith and the project owner contained an arbitration clause. Godwin sued Smith for breach of contract, breach of the South Carolina Unfair Trade Practices Act, and fraud. Thereafter, Smith moved to stay the proceedings and compel arbitration.³⁷ The trial court denied the motion and Smith appealed.³⁸

Both state and federal policy favor arbitration.³⁹ Furthermore, both the Federal Arbitration Act⁴⁰ and the South Carolina Uniform Arbitration Act⁴¹ contain specific requirements that parties must meet before a contract is subject to arbitration. The Federal Act provides: "If any suit or proceeding be brought . . . upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending . . . shall on application of one of the parties stay the trial of the action until such arbitration has been

33. 300 S.C. 90, 386 S.E.2d 464 (Ct. App. 1989).

34. *Id.* at 93, 386 S.E.2d at 466.

35. *Id.* at 95, 386 S.E.2d at 467.

36. *Id.* at 91, 386 S.E.2d at 465.

37. *Id.*

38. *Id.*

39. *Trident Technical College v. Lucas & Stubbs, Ltd.*, 286 S.C. 98, 103-04, 333 S.E.2d 781, 784-85 (1985) *cert. denied*, 474 U.S. 1060 (1986).

40. 9 U.S.C. §§ 1-14 (1970).

41. S.C. CODE ANN. §§ 15-48-10 to -240 (Law. Co-op. Supp. 1989).

had”⁴² The South Carolina Act, however, unlike the Federal Act, contains a stringent notification requirement. The South Carolina act provides that before an agreement can be subject to arbitration, “Notice that [the] contract is subject to arbitration . . . [and] shall be typed in underlined capital letters, or rubber-stamped prominently, on the first page of the contract and unless such notice is displayed thereon the contract shall not be subject to arbitration.”⁴³

Although the South Carolina Act requires this notice, the South Carolina Supreme Court has recognized that federal substantive law supplants state arbitration law when the transaction affects interstate commerce.⁴⁴ Moreover, South Carolina courts have held that, under the federal act, parties can incorporate arbitration agreements by reference.⁴⁵ In fact, in *First Baptist Church of Timmonsville v. George A. Creed & Son*⁴⁶ the supreme court compelled arbitration between a contractor and a church and stated: “We think that, in the absence of a showing of fraud, mistake, unfair dealing or the like, a party to a contract incorporating an arbitration provision cannot escape the obligation of such a provision by simply declaring: ‘But I did not read the whole agreement.’”⁴⁷

The contract between Godwin and Smith did not contain an express arbitration clause and the parties did not type or print a notice that the contract was subject to arbitration on the first page of the contract.⁴⁸ The contract did, however, state that Godwin “agree[d] to furnish all materials and perform all work . . . in accordance with the General Conditions of the Contract between the Owner and the Contractor . . . which General Conditions . . . hereby become a part of this contract.”⁴⁹ The contract between Smith and the owner, however, did contain an arbitration clause.⁵⁰ The court of appeals, in reversing the trial court, stated, “It is well settled that, under the Federal Arbitration Act, an agreement to arbitrate may be validly incorporated into a subcontract by reference to an arbitration provision in a general

42. 9 U.S.C. § 3 (1970).

43. S.C. CODE ANN. § 15-48-10(a) (Law Co-op. Supp. 1989).

44. *Trident Technical College*, 286 S.C. at 104, 333 S.E.2d at 785.

45. See *First Baptist Church of Timmonsville v. George A. Creed & Son, Inc.*, 276 S.C. 597, 599, 281 S.E.2d 121, 122-23 (1981). But see *Shaw v. East Coast Builders of Columbia, Inc.*, 291 S.C. 482, 354 S.E.2d 392 (1987) (contract with a “General Conditions” section containing an arbitration provision and also a contract addendum with a “General Conditions” section without an arbitration provision was ambiguous and created a litigable issue).

46. 276 S.C. 597, 281 S.E.2d 121 (1981).

47. *Id.* at 599, 281 S.E.2d at 123.

48. *Godwin*, 300 S.C. at 91-92, 386 S.E.2d at 465.

49. *Id.*

50. *Id.* at 92, 386 S.E.2d at 465.

contract.”⁵¹

The court further held that the stringent notification requirements of South Carolina Code section 15-48-10(a)⁵² did not apply because the transaction between Godwin and Smith affected interstate commerce.⁵³ The *Godwin* court quoted the South Carolina Supreme Court’s opinion in *Episcopal Housing Corp. v. Federal Insurance Co.*:⁵⁴ “[U]nder the supremacy clause of the United States Constitution, Article VI, Clause 2, this Court must recognize that federal statutes enacted pursuant to the United States Constitution are the supreme law of the land.”⁵⁵

The *Godwin* decision demonstrates South Carolina’s judicial policy favoring arbitration. Coupled with this policy is a willingness to take a liberal approach in finding evidence of interstate commerce in order to apply the federal act. Because most construction projects obtain either material or labor from out of state suppliers, the contracts usually affect interstate commerce. Thus, the state act will often apply in construction cases.

The judicial arbitration preference policy apparently outweighs the state legislative mandate that both parties to a contract be made fully aware that the contract is subject to arbitration. Thus, the *Godwin* decision demonstrates the necessity of scrutinizing contract language for any attempt to incorporate unattached documents.

Anthony L. Harbin

III. REAL ESTATE BROKER NOT ENTITLED TO COMMISSION AFTER TERMINATION OF AGENCY CONTRACT

In *Webb v. First Federal Savings & Loan Association of Anderson*⁵⁶ the South Carolina Court of Appeals held that a real estate bro-

51. *Id.* at 93, 386 S.E.2d at 466 (quoting *Maxum Found., Inc. v. Salus Corp.*, 779 F.2d 974, 978 (4th Cir. 1985)).

52. S.C. CODE ANN. § 15-48-10(a) (Law. Co-op. Supp. 1989).

53. The court of appeals, in *Circle S. Enters., Inc. v. Stanley Smith & Sons*, 288 S.C. 428, 343 S.E.2d 45 (Ct. App. 1986), had previously quoted *Snyder v. Smith*, 736 F.2d 409 (7th Cir.), *cert. denied*, 469 U.S. 1037 (1984), for the proposition that “the requirement of the [Federal] Act that a contract evidence a transaction involving commerce must be broadly construed to promote arbitration.” 288 S.C. at 430, 343 S.E.2d at 46. The parties in this case did not dispute that the contract would affect interstate commerce. See *Godwin v. Stanley Smith & Sons*, 300 S.C. 90, 92, 386 S.E.2d 464, 465 (Ct. App. 1989).

54. 269 S.C. 631, 239 S.E.2d 647 (1977).

55. *Godwin*, 300 S.C. at 95, 386 S.E.2d at 467 (quoting *Episcopal Hous. Corp. v. Federal Ins. Co.*, 269 S.C. 631, 239 S.E.2d 647 (1977)).

56. 299 S.C. 1, 382 S.E.2d 4 (Ct. App. 1989).

ker, who claims a commission under an express contract or a contract implied in fact, is entitled to compensation only if his efforts were the procuring cause of the transaction, and he intervened during the continuance of the agency contract.⁵⁷ Although the court found no South Carolina Supreme Court authority to support the broker's claim based upon a contract implied in law, the court of appeals did not rule out the possibility of recovery in quantum meruit on different facts.⁵⁸

The dispute began when Burger King Corporation contacted Webb, a real estate broker, to find the corporation a new location for a restaurant in Anderson. Webb located a potentially suitable lot owned by First Federal Savings and Loan. In 1984 First Federal offered to sell the property to Burger King. Webb would be entitled to a commission on the sale when Burger King accepted the offer. Burger King, however, refused First Federal's offer. Webb assured First Federal that he would try to persuade Burger King to change its mind, and he continued to stay in touch with Burger King about the First Federal property. In January 1985, Burger King asked Webb to contact First Federal about the availability of the lot. First Federal stated that the lot was not available. Webb asked about the lot again in July 1985 after Burger King inquired about its availability for purchase at a higher price or for lease. First Federal rejected Burger King's overture.⁵⁹ In September 1985, however, First Federal began negotiations with a separate Burger King franchisee. First Federal and the franchisee reached an agreement in December 1985 under which a wholly owned subsidiary of First Federal would construct and lease a building to the franchisee.⁶⁰

Webb brought an action against First Federal seeking his commission on the Burger King lease. He sued First Federal for breach of a contract implied in fact between Webb and First Federal and also sued in quantum meruit. Webb won a jury verdict on these claims.⁶¹ The trial court denied First Federal's motions for judgment notwithstanding-

57. *Id.* at 6-7, 382 S.E.2d at 7.

58. *See id.* Quantum meruit means "as much as he deserves" and "describes the extent of liability on a contract implied in law." BLACK'S LAW DICTIONARY 1119 (5th ed. 1979).

59. *Webb*, 299 S.C. at 3, 382 S.E.2d at 5.

60. *Id.*

61. *Id.* at 2, 382 S.E.2d at 3. Webb's complaint alleged four causes of action: (1) breach of an express contract for payment of real estate commissions; (2) a claim for compensation based upon quantum meruit; (3) breach of a contract accompanied by a fraudulent act; and (4) breach of a contract implied in fact between Webb and First Federal. The trial court granted First Federal's motion for a directed verdict on the first and third claims, but denied the motion on the claims for quantum meruit and breach of a contract implied in fact. Record at 1-2.

ing the verdict and a new trial.⁶² The court of appeals reversed.⁶³

Under South Carolina law, to recover a commission on an express or implied in fact contract, a broker must establish that a contract for payment of a commission existed between himself and the principal at the time the broker rendered the services.⁶⁴ Because no express contract existed between First Federal and Webb after Burger King's rejection of the offer in July 1984⁶⁵ the court of appeals also dismissed the possibility of the existence of a contract implied in fact arising after this date. Before a contract implied in fact can arise,

[T]he principal must either do or say something tending to prove he accepted the broker as his agent in the matter and the principal must either know or have reason to believe that the services were rendered on his behalf and to his benefit by the broker with the expectation of receiving compensation from the principal.⁶⁶

After reviewing the evidence, the court found that First Federal's conduct was not sufficient to show that First Federal had agreed Webb was to be its agent in the lease of the property.⁶⁷ Webb neither introduced the franchisee to First Federal, nor was he involved in any negotiations pertaining to the lease. After Burger King's rejection of First Federal's offer to sell, Webb's only substantial contacts with First Federal were made at the request of Burger King in its efforts to reopen negotiations for a possible sales transaction between Burger King and First Federal.⁶⁸ The court concluded that Webb's actions did not give First Federal notice that he expected a commission on the lease.⁶⁹

The court of appeals also denied recovery to Webb based on the theory of a contract implied in law.⁷⁰ The court held that a broker is

62. *Webb*, 299 S.C. at 2, 382 S.E.2d at 5.

63. *Id.*

64. *Hilton Head Island Realty, Inc. v. Skull Creek Club*, 287 S.C. 530, 536, 339 S.E.2d 890, 893 (Ct. App. 1986); see Note, *Real Estate Brokers Contracts in South Carolina*, 18 S.C.L. REV. 819, 825 (1966).

65. *Webb*, 299 S.C. at 5, 382 S.E.2d at 6.

66. *Hilton Head Island Realty, Inc.*, 287 S.C. at 536, 339 S.E.2d at 893.

67. *Webb*, 299 S.C. at 7, 382 S.E.2d at 7.

68. See *id.* at 3, 382 S.E.2d at 5.

69. *Id.* at 7, 382 S.E.2d at 7.

70. The court clarified the distinction between a contract implied in fact and a contract implied in law (also commonly referred to as "quasi contract"):

Restitution is a remedy designed to prevent unjust enrichment. Historically the form of action for this remedy was assumpsit, although no contract, express or implied, existed between the plaintiff and the defendant. Because of this quirk of common law pleading, the term "contract implied in law" has been used to describe the circumstances under which the law imposes an obligation to make restitution for a benefit received, despite the absence of any agreement between the parties. The unfortunate use of "implied contract" to

not entitled to commissions on the consummation of a sale or other transaction of property occurring after termination of his agency contract, even though the broker was responsible for the sale or for the purchaser's interest in the property.⁷¹ The court held that First Federal did not owe Webb a commission on a contract implied in law and concluded that a broker is entitled to a commission only for efforts during the term of an express or implied in fact agency contract.⁷²

Although the court of appeals adopted the view held by most jurisdictions when it refused to apply the theory of quantum meruit in *Webb*,⁷³ it is significant that the court expressly left open the possibility that the South Carolina Supreme Court might hold in a future case that a broker is entitled to his commission by reason of a contract implied in law.⁷⁴

The supreme court's opinion in *United Farm Agency v. Malanuk*⁷⁵ suggests that principles of quantum meruit may play a role in broker commission cases. In *Malanuk* the broker was attempting to locate a home for a client. He approached the owners of a home who had placed a "For Sale by Owner" sign on their property and asked for permission to show the home to his client. The owners gave a house key to the broker and allowed him to show their house. The parties made no agreement about a commission, and they did not sign a listing agreement. The broker's client made an earnest money deposit on the house, and the broker gave the owner notice of this deposit. A few days later, the purchaser withdrew her offer, and the broker returned the

connote both true ("implied in fact") and quasi ("implied in law") contracts has led to much confusion. The distinction, however, is clear. A contract "implied in fact" arises when the assent of the parties is manifested by conduct, not words. A quasi contract, or one implied in law, is no contract at all, but an obligation created by the law in the absence of any agreement between the parties.

Id. at 4, 382 S.E.2d at 6 (citations omitted) (quoting *Stanley Smith & Sons v. Limestone College*, 283 S.C. 430, 434-35 n.1, 322 S.E.2d 474, 478 n.1 (Ct. App. 1984)).

71. *Id.* at 5-6, 382 S.E.2d at 6-7.

72. *Id.* at 7, 382 S.E.2d at 7.

73. See *Hobbs v. Hudgens*, 223 S.C. 88, 96, 74 S.E.2d 425, 427-428 (1953) ("[T]he broker must not only show that his efforts were [the] procuring cause of the sale but must further show that his intervention was during the continuance of an agency to sell or to find a purchaser."); *Hutson v. Stone*, 119 S.C. 259, 263, 112 S.E. 39, 40 (1922) ("[A] real estate broker is entitled to compensation, where the sale is effected during the continuance of the broker's agency"); *Goldsmith v. Coxe*, 80 S.C. 341, 346, 61 S.E. 555, 557 (1908) ("[T]he broker is entitled to his commissions, if, during the continuance of his agency, he is the efficient or procuring cause of the sale"). See also Annotation, *Broker's Right to Commission on Sales Consummated after Termination of Employment*, 27 A.L.R.2d 1348 (1953) (general discussion with case citations).

74. *Webb*, 299 S.C. at 7, 382 S.E.2d at 7.

75. 284 S.C. 382, 325 S.E.2d 544 (1985).

earnest money deposit. The broker's client subsequently purchased the house directly from the owner.⁷⁶

The South Carolina Supreme Court upheld the trial court's award of a commission to the broker in *Malanuk* and stated, "A broker has generally earned his commission when he acts during his agency as the efficient or procuring cause of a sale, though the actual sales contract is made by the owner without the broker's aid."⁷⁷ The *Malanuk* court stated that a "sales contract . . . entered into without the broker's knowledge does not defeat the rights of the broker to a commission."⁷⁸ Although the court indicated that the parties established an agency relationship in *Malanuk*, it did not indicate whether the parties had terminated this agency relationship.

The purchaser's return of her earnest money arguably terminated the agency relationship and suggests that the court may have awarded the broker a commission on a contract implied in law rather than a contract implied in fact. If this interpretation is accurate, then the supreme court has determined, notwithstanding the court of appeals comments to the contrary in *Webb*,⁷⁹ that a broker may recover in quantum meruit even though the sale or other transaction is not consummated during the continuance of the broker's agency. Given this perspective, a broker would only need to show that during his agency he was the procuring cause of the transaction.

Even if quantum meruit recovery was available to brokers in appropriate circumstances, the court in *Webb* found no facts giving rise to a contract implied in law. Although similarities between *Webb* and *Malanuk* exist, the facts in *Webb* differ significantly in one respect. In *Malanuk* the broker had brought the property to the attention of the ultimate purchaser. In *Webb* the broker played no part in the lease negotiations between First Federal and the franchisee. This fact may have been a significant factor in the supreme court's decision to award the broker his commission.

The court of appeals' decision does not necessarily preclude recognition of a contract implied in law in a slightly different fact situation. If Burger King, rather than a franchisee, had been the ultimate lessee, *Webb* would have had a stronger argument that his efforts ultimately led to the lease arrangement between First Federal and Burger King. *Webb* introduced the parties and took part in the sales negotiations between them. *Webb* could argue that he had conferred a benefit upon First Federal and that it would be inequitable for First Federal to re-

76. *Id.* at 383-84, 325 S.E.2d at 545.

77. *Id.* at 384, 325 S.E.2d at 545.

78. *Id.*

79. *See* 299 S.C. at 7, 382 S.E.2d at 7.

ceive this benefit without paying him for his efforts.⁸⁰

Regardless of the interpretation given *Malanuk*, *Webb* indicates that South Carolina has not yet closed the door to recovery in quantum meruit by brokers under different circumstances in the future.

Robert H. Mazingo

IV. FOURTH CIRCUIT DENIES ACTION FOR BREACH OF A DISTRIBUTORSHIP AGREEMENT WHEN SUPPLIER DISCONTINUED LINE OF INVENTORY

In *Valtrol, Inc. v. General Connectors Corp.*⁸¹ the Fourth Circuit Court of Appeals held that an exclusive distributorship agreement did not entitle the distributor to an action for breach of contract when the supplier discontinued its line of inventory, despite a clause in the agreement that required mutual consent for termination.⁸² The court also held that neither subsequent writings nor conduct of the parties altered a conspicuous disclaimer of all implied warranties.⁸³

The action arose out of an exclusive distributorship agreement between a national supplier, General Connectors Corporation (General Connectors), and one of its distributors, Valtrol, Inc. (Valtrol). The agreement stated each party's sales and promotion obligations and was renewed each July 1. At Valtrol's request, a party had to obtain mutual consent and ninety days notice to terminate the agreement. In May 1986 General Connectors notified Valtrol that it was terminating its steam trap division on June 30. Valtrol received the last shipment of steam traps in August.⁸⁴

Valtrol subsequently brought a diversity action for breach of contract and breach of warranty and sought, among other things, damages for lost profits and cost of coverage. The United States District Court directed a verdict for General Connectors on the warranty claim and

80. This conclusion is reached by applying the elements of a contract implied in law as outlined by the court in *Webb*. The elements are: (1) a benefit conferred upon the defendant by the plaintiff; (2) realization of that benefit by the defendant; and (3) retention by defendant of the benefit under conditions that make it inequitable for him to retain it without paying its value. *Id.* at 5, 382 S.E.2d at 6.

81. 884 F.2d 149 (4th Cir. 1989).

82. *Id.* at 152-54. The court noted that the substantive law of Texas governed the contract. *Id.* at 151. Despite the court's application of Texas law to the breach of contract claim, the decision is independently reasoned and should influence other decisions in the Fourth Circuit. *See id.* at 153-54.

83. *Id.* at 154-55. The court applied South Carolina law to the breach of warranty claim. *Id.*

84. *Id.* at 150-51, 153.

granted judgment *non abstante veredicto* (J.N.O.V.) for General Connectors on the breach of contract claim after the jury awarded Valtrol \$215,000.⁸⁵ The Fourth Circuit affirmed the J.N.O.V. because the mutual consent termination provision presupposed both that "a viable joint enterprise" would exist and that the parties would remain in the market for steam traps.⁸⁶ The court noted that a party's cessation of business generally will not give rise to an action for the breach of a distributorship contract because most distributorship contracts are terminable at will by either party.⁸⁷

Valtrol claimed that because the contract contained a mutual consent requirement for termination, General Connectors should be liable for the damages that resulted from an implied contractual duty to remain in business. The court disagreed, however, and compared the distributorship agreement to a requirements or output contract, which includes a duty for a company to use commercially reasonable efforts to advance the joint enterprise rather than a duty to operate the business in all circumstances.⁸⁸ The court's decision that a mutual consent requirement for the termination of the contract did not create an implied duty to remain in business prevents one party from suffering perpetual losses. The court also stated, however, that economic difficulties generally will not relieve parties of their contractual obligations.⁸⁹ Thus, the court created a rule that protects both parties.

When it affirmed the directed verdict, the court described Valtrol's purchase orders⁹⁰ as an acceptance or a confirmation of General Connectors' continuing offer to sell steam equipment. The terms of several purchase orders, however, would have expanded the express limited warranty. The court held that these were either different terms or additional terms that materially altered the agreement.⁹¹ As a result, the court held that under South Carolina Code sections 2-207(1) and 2-207(2), these terms could not become part of the agreement.⁹² Finally, the court held that section 2-207(3) did not apply because a written

85. *Id.* at 151-52.

86. *Id.* at 153. It is undisputed that General Connectors discontinued its steam trap division because of consistent net operating losses.

87. *Id.*; see also *Kenan, McKay & Spier v. Yorkville Cotton Oil Co.*, 260 F. 28 (4th Cir. 1919) (output contract for sale of cotton not breached by mill's cessation of business).

88. *Valtrol, Inc.*, 884 F.2d at 153.

89. *Id.* at 153-54.

90. Several of the purchase orders included terms that purported to alter the limited warranty contained in the distributorship agreement. *Id.* at 154.

91. *Id.* at 155.

92. Choice of law provisions do not apply to implied warranty claims. The court does not discuss why it applied South Carolina law to the implied warranty claims, and the propriety of its application is assumed herein.

contract existed.⁹³

Only three South Carolina cases have interpreted section 36-2-207.⁹⁴ The courts in two of the cases held that additional terms between merchants become part of the contract unless those terms materially altered the agreement.⁹⁵ In the third case, *T.E. Cuttino Construction Co. v. Rigid Steel Structures*⁹⁶ the Fourth Circuit held that, even though subsequent forms contained additional terms that materially altered the contract, the new terms became part of the agreement because both parties were aware of the trade custom in which parties included such terms.⁹⁷ The decision in *Valtrol*, therefore, is consistent with existing South Carolina law.

The court's refusal to allow subsequent purchase orders to materially alter the limited warranty in the distributorship agreement is inconsistent with its decision in *Rigid Steel Structures*, however, the de-

93. *Valtrol, Inc.*, 884 F.2d at 155. The South Carolina Code, which adopted the Uniform Commercial Code, provides:

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it; or
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this act.

S.C. CODE ANN. § 36-2-207 (Law. Co-op. 1976).

94. See *T.E. Cuttino Constr. Co. v. Rigid Steel Structures*, 869 F.2d 594 (4th Cir. 1989) (text available in WESTLAW No. 88-3913) (allows government specifications to become part of a construction contract despite lack of agreement by the parties); *Hinson-Barr, Inc. v. Pinckard*, 292 S.C. 267, 356 S.E.2d 115 (1987) (agreement for sale of restaurant equipment materially altered by invoice that substantially increased selling price); *Mace Indus., Inc. v. Paddock Pool Equip. Co.*, 288 S.C. 65, 339 S.E.2d 527 (Ct. App. 1986) (buyer of water treatment equipment bound by seller's terms, however, additional terms contained in purchase order became part of contract only to extent terms did not materially alter the proposed contract).

95. See *Hinson-Barr*, 292 S.C. at 269, 356 S.E.2d at 116; *Paddock Pool Equip. Co.*, 288 S.C. at 70, 339 S.E.2d at 530.

96. 869 F.2d 594 (4th Cir. 1989) (text available in WESTLAW No. 88-3913).

97. *Id.*

cision aligns the Fourth Circuit with prior South Carolina law.⁹⁸ Moreover, because of *Rigid Steel Structures*,⁹⁹ material alterations by additional or different terms will not become part of a prior contract in South Carolina.

Finally, although the court's reasoning in *Valtrol* is sound, whether the rule allows subsequent "subcontracts" by conduct that materially alters the agreement is not clear, even though such alteration is allowed under the code. Parties that recognize a contract by their conduct, which is contrary to the written forms, could argue that the Code's implied warranties of fitness and merchantability should supplement the agreement, even if the original writings contain a disclaimer. The court's reasoning in *Valtrol*, however, seems to preclude any subsequent alteration of a distributorship agreement absent the explicit intent by the parties to make such an alteration.

Karl J. Forrest

V. "DISCOVERY RULE" EXTENDED TO CONTRACT CAUSES OF ACTION

In *Santee Portland Cement Co. v. Daniel International Corp.*¹⁰⁰ the South Carolina Supreme Court held that the discovery rule applies to the statute of limitations for contract actions under section 15-3-530(1) of the South Carolina Code.¹⁰¹ Under the discovery rule the statute of limitations is tolled until the plaintiff knows or by the exercise of reasonable diligence should have known that he had a cause of action.¹⁰² Consequently, the three-year statute of limitations for "an action upon a contract, obligation or liability, express or implied"¹⁰³ is

98. See *Hinson-Barr*, 292 S.C. 267, 356 S.E.2d 115; *Paddock Pool Equip. Co.*, 288 S.C. 65, 339 S.E.2d 527.

99. The court explained its decision as follows:

We . . . agree that the additional terms in the subcontract materially altered the offer. Nonetheless, we hold that Rigid accepted those terms as part of the contract when it retained the deposit and began work on the project. We base our conclusion on the particular facts of this case where, of great import is the fact that Rigid and Mesco both knew that they were working under a governmental contract that involved buildings required to be built in accordance with government plans and specifications.

T.E. Cuttino Constr. Co. v. Rigid Steel Structures, 869 F.2d 594 (4th Cir. 1989) (text available in WESTLAW No. 88-3913).

100. 299 S.C. 269, 384 S.E.2d 693 (1989).

101. *Id.* at 274, 384 S.E.2d at 696.

102. *Dillon County School Dist. No. Two v. Lewis Sheet Metal Works, Inc.*, 286 S.C. 207, 215, 332 S.E.2d 555, 559 (Ct. App.), cert. granted, 287 S.C. 234, 337 S.E.2d 697 (1985), cert. dismissed, 288 S.C. 468, 343 S.E.2d 613 (1986).

103. S.C. CODE ANN. § 15-3-530(1) (Law. Co-op. 1976 & Supp. 1989).

tolled until the plaintiff knows or should have known that the contract has been breached by the defendant.

In April 1986 the Santee Portland Cement Company (Santee) commenced an action against Daniel International Corporation (Daniel) for breach of a May 1965 contract. The contract required Daniel and its sub-contractors to construct a cement storage silo complex that would consist of twelve circular concrete silos, six interstices, and three pocket bins. Daniel completed the complex in 1966 and operated the complex for fourteen years with only minor problems.¹⁰⁴

During September 1980 one of the complex's three bins ruptured. Two people were killed and extensive property damage resulted. Santee conducted an investigation which revealed that the complex's twelve silos were structurally unsound and in need of repair.¹⁰⁵ Santee filed an action in both tort and contract in April 1986.¹⁰⁶ To avoid a dismissal of the action because the statute of limitations had run,¹⁰⁷ Santee urged the court to extend the discovery rule to contract actions. The trial judge declined to apply the rule and granted Daniel's motion for a directed verdict.¹⁰⁸ On appeal the supreme court affirmed the case in part,¹⁰⁹ but reversed the trial court on the issue of the applicability of the discovery rule to contract actions.¹¹⁰

The supreme court's adoption of the discovery rule in contract actions is a significant departure from prior South Carolina case law. South Carolina courts historically have held that a cause of action for breach of contract accrues at the time of the breach.¹¹¹ In *Livingston v.*

104. *Santee Portland Cement Co.*, 299 S.C. at 270, 384 S.E.2d at 693-94.

105. *Id.* at 270-71, 384 S.E.2d at 694.

106. The trial court granted summary judgment on the tort cause of action and ruled that the plaintiff's exclusive remedy was in contract. *Id.* at 271, 384 S.E.2d at 694.

107. At the time Santee filed this case, a six-year statute of limitation applied to actions on a contract. S.C. CODE ANN. § 15-3-530(1) (Law. Co-op. 1976). The statute has since been amended to allow only three years to bring actions on contracts. *Id.* (Law. Co-op. 1976 & Supp. 1989).

108. *Santee Portland Cement Co.*, 299 S.C. at 271, 384 S.E.2d at 694. In making this ruling, the court indicated that even under the discovery rule the statute of limitations had run. The trial court held, as a matter of law, that by 1975 Santee had notice of the defects in the project. *Id.* at 273, 384 S.E.2d at 695.

109. The court affirmed without comment the trial court's holding that Santee's exclusive remedy was in contract. *Id.* at 271, 384 S.E.2d at 694.

110. *Id.* at 274, 384 S.E.2d at 696. The court also reversed the trial court's finding that Santee's claim was time-barred as a matter of law, even if the court applied the discovery rule. The court held that when Santee had or should have had notice of the defects in the project was a question for the jury. *Id.*

111. See *Executors of Sinclair v. Bank of S.C.*, 33 S.C.L. (2 Strob.) 344, 345 (1847); *Sams v. Rhett*, 27 S.C.L. (2 McM.) 171, 183 (1842); *Executors of Thomas v. Executors of Ervin*, 25 S.C.L. (Chev.) 22, 25 (1839).

Sims,¹¹² a leading South Carolina case on this issue, the South Carolina Supreme Court held that “[a]n action resting on breach of contract generally accrues at the time the contract is broken, although substantial damages from the breach are not sustained until afterward.”¹¹³ The *Santee* court, however, relied on recent South Carolina cases that favor the discovery rule¹¹⁴ and overruled *Livingston* to the extent it was inconsistent with the rule.¹¹⁵

Although the legislature enacts statutes of limitations to protect defendants from fraudulent claims by assuring them a chance to obtain fresh evidence, the supreme court noted that “[t]his concern must be balanced against a plaintiff’s interest in prosecuting an action and pursuing his rights. Plaintiffs should not suffer where circumstances prevent them from knowing they have been harmed.”¹¹⁶ The court also suggested that statutes of limitations should not be applied mechanically, but should be applied to achieve “the requirements of substantial justice for all parties involved.”¹¹⁷

The supreme court also rebutted an argument based on the legislature’s possible intent in amending some, but not all, of the provisions in the South Carolina Code dealing with limitations periods. Daniel argued that “because the legislature enacted special discovery provisions in sections 15-3-535 and 15-3-545 and did not act with reference to any of the other sub-sections of section 15-3-530, we must assume that the legislature decided against application of the discovery rule to these sections.”¹¹⁸ The majority admitted that the “inclusion of certain provisions in a statute may be *some* evidence that the exclusion of others was purposeful,”¹¹⁹ but countered that the legislature was merely addressing issues raised by a case¹²⁰ the District Court of South Carolina decided immediately prior to the legislature’s amendments.¹²¹ The majority then stated that “[t]here is nothing to indicate that the legislature considered the applicability of the rule to other causes of action.”¹²² Indeed, the majority considered the amendments as legisla-

112. 197 S.C. 458, 15 S.E.2d 770 (1941).

113. *Id.* at 462, 15 S.E.2d at 772.

114. See, e.g., *Campus Sweater & Sportswear Co. v. M.B. Kahn Constr. Co.*, 515 F. Supp. 64, 78-79 (D.S.C. 1979), *aff’d*, 644 F.2d 877 (4th Cir. 1981); *Mills v. Killian*, 273 S.C. 66, 70, 254 S.E.2d 556, 558 (1979).

115. *Santee Portland Cement Co.*, 299 S.C. at 273, 384 S.E.2d at 695.

116. *Id.* at 271, 384 S.E.2d at 694.

117. *Id.* at 272, 384 S.E.2d at 694 (quoting *Gattis v. Chavez*, 413 F. Supp. 33, 39 (D.S.C. 1976)).

118. *Id.* at 273, 384 S.E.2d at 695.

119. *Id.* (quoting *Gattis*, 413 F. Supp. at 37) (emphasis in original).

120. *Gattis*, 413 F. Supp. at 33.

121. *Santee Portland Cement Co.*, 299 S.C. at 273, 384 S.E.2d at 695.

122. *Id.* The dissent was unimpressed with this line of reasoning and noted that the

tive expansion of the discovery rule, comparable to similar judicial expansions by the court.¹²³

The South Carolina Supreme Court's decision to apply the discovery rule to the statute of limitations for contract actions is justified. Any refusal to adopt the discovery rule would be contrary to prior South Carolina court decisions¹²⁴ that dealt with contract law but were resolved on the basis of tort law.

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changes made by the legislature affected causes of action "*not arising on contract.*" *Id.* at 275, 384 S.E.2d at 696 (Gregory, C.J., dissenting) (emphasis in original). As to the majority's reliance on *Gattis*, the dissent argued that "cases cited from the federal district court are not controlling or even persuasive here." *Id.* The dissent also disagreed with the majority's decision to overrule *Livingston*. *Id.*

123. *Id.* at 272, 384 S.E.2d at 694. For a discussion of judicial expansion of the rule, see *supra* note 114 and accompanying text.

124. *Campus Sweater & Sportswear Co. v. M.B. Kahn Constr. Co.*, 515 F. Supp. 64, 78 (D.S.C. 1979); *Dillon County School Dist. No. Two v. Lewis Sheet Metal Works, Inc.*, 286 S.C. 207, 332 S.E.2d 555 (Ct. App.), *cert. granted*, 287 S.C. 234, 337 S.E.2d 697 (1985), *cert. dismissed*, 288 S.C. 468, 343 S.E.2d 613 (1986).