

COMMONWEALTH OF KENTUCKY
SUPREME COURT
NO. 2011-SC-000462-D



ENERGY HOMES, DIVISION
OF SOUTHERN ENERGY HOMES, INC.

APPELLANT

v.

BRIEF FOR APPELLANT, ENERGY HOMES,
DIVISION OF SOUTHERN ENERGY HOMES, INC.

BRIAN PEAY AND HIS WIFE, LORI PEAY

APPELLEES

On Discretionary Review of the Court of Appeals NO. 2009-CA-000657
Appeal from Daviess Circuit Court No. 08-CI-01493

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CERTIFICATE REQUIRED BY CR 76.12(6)

The undersigned does hereby certify that copies of this brief were served upon the following named individuals by U.S. Mail this 12th day of October, 2012: Hon. Zack N. Womack, Womack Law Offices, P.O. Box 637, Henderson, KY 42419; Hon. Stephen D. Gray, Dorsey, King, Gray, Norment & Hopgood, 318 2nd St., Henderson, KY 42420; Hon. Deanna M. Tucker, Schiller, Osbourn, Barnes & Maloney, PLLC, 1600 One Riverfront Plaza, 401 W. Main St., Louisville, KY 40202; Hon. Beth A. Lochmiller, Coleman, Lochmiller & Bond, P.O. Box 1177, Elizabethtown, KY 42702, and the Honorable Joe Castlen, 100 E. 2nd Street, Owensboro, KY 42303, and Mr. Samuel P. Givins, Jr. Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601. The undersigned does also certify that the record on appeal was not withdrawn by this party.

BY:


ELIZABETH A. DEENER

INTRODUCTION

The issues before this Court are whether the Daviess Circuit Court improperly denied the Motion to Compel Arbitration pursuant to the Arbitration Agreement executed by the Appellees on June 26, 2006 at the closing of the sale of this subject home as unconscionable and contrary to Federal and Kentucky law.

STATEMENT CONCERNING ORAL ARGUMENT

The Appellant, Energy Homes, Division of Southern Energy Homes, Inc., believes oral argument would be useful in presenting the issues before the Court.

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STATEMENT OF THE CASE

I. FACTUAL BACKGROUND

In November 2005, Brian Peay, on behalf of himself and his wife, entered into a contract to purchase a home manufactured by Southern Energy Homes, Inc. ["SEHI"] from American Dream Housing, Inc. ["American Dream"]. American Dream is not a party to this Appeal. (Complaint ¶8, R.1-7). At that time, a Purchase Agreement was entered into between Brian Peay and American Dream. ®. 285). No purchase agreement existed between SEHI and the Peays. The subject home was manufactured in Alabama and was delivered to American Dream in Owensboro, Kentucky, on or about January 30, 2006.

American Dream delivered the home to the Appellee's property in Owensboro. The home was set up and/or placed by Jerry Morris Construction, over a foundation and basement dug at the Peay's direction and through their contract with Jerry Morris Construction. (Complaint at ¶10-11, R. 1-7). The plumbing on the house was performed by Larry Hayden. Id. Neither Jerry Morris Construction nor Larry Hayden are parties to this appeal or the agreement at issue here. SEHI had no relationship with, direction of, or control over Jerry Morris Construction or Larry Hayden, and no allegations have been made that SEHI had such a relationship.

The date of closing for the sale of the home was June 26, 2006. When Brian Peay received the home he also received a warranty book from SEHI. This warranty book contained express warranties offered by SEHI to the new homeowner; American Dream was not a party to the express warranties. In consideration for the express warranties from SEHI contained in the book, and in acknowledgment of the receipt of said warranties, Brian Peay,

on behalf of himself and his wife, signed an agreement attached to the warranty book entitled “Binding Arbitration Agreement and Jury Waiver” [hereinafter “Arbitration Agreement”], between Mr. Peay and SEHI wherein he expressly agreed to submit any and all disputes involving SEHI to arbitration. (Exhibit A to the Affidavit of Don McNutt, Apx. D, R. 94-95) (emphasis original). This Arbitration Agreement was signed by Mr. Peay, on behalf of himself and Mrs. Peay; by a representative of American Dream; and by a representative of SEHI. Id.

A copy of the Arbitration Agreement was forwarded to SEHI. (Exhibit A to the Affidavit of Don McNutt, R. 94-95). The Arbitration Agreement stated that the Peays agreed 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.

* * *

TERMS

Note that this Agreement provides for mandatory and binding arbitration. This means that You and We must arbitrate claims and disputes covered by this Agreement.

Construction of this Agreement

You and We will abide by this Agreement to arbitrate, regardless of any term to the contrary in any other writing, unless such other writing specifically refers to this Agreement.

* * *

IMPORTANT - JURY WAIVER

You and We hereby irrevocably waive our right to trial by jury on any claims that You now have or may have hereafter acquire against Us or that We may hereafter acquire against You. This waiver will remain enforceable even if this Agreement, or any portion of it, is otherwise found to be unenforceable.

(Apx. D, R. 95-96) (emphasis in the original). This agreement contained several express and overt notices that it was an agreement to refer disputes between the Peays and SEHI to mandatory arbitration with a waiver of jury trial. *Id.*

This Arbitration Agreement was more fully explained to Mr. Peay in the “Closing Video,” which he watched on June 26, 2006. After viewing, he signed and acknowledged a copy of the closing video transcript. (Exhibit B to the Affidavit of Don McNutt, Apx. E, R. 96-97). This Closing Video set out the steps necessary for successful site selection, delivery, and installation of the new home. The transcript also included a restatement of the Arbitration Agreement. (Apx. E, R. 96-97). Brian Peay viewed the Closing Video and signed the Closing Video script on June 26, 2006. Mr. Peay executed the Binding Arbitration Agreement and Jury Waiver on June 26, 2006, as evidenced by his signature. (®. 94-97.) He also signed and submitted “Original Home Owner Registration Card” which was stamped upon receipt by SEHI as “WARRANTY CARD” to show receipt and acknowledgment of the extended warranty agreement. (Exhibit C to the Affidavit of Don McNutt, Apx. F, R. 98)

Lori Peay, on behalf of herself and her husband Brian Peay, sought and received warranty service from SEHI on the subject home after closing. (SEHI Response to Request for Production SE0051-52, 54; R. 150-51, 153, Apx. G). This included work under warranty on November 6, 2006 and November 22, 2006. Id. Lori Peay, not her husband Brian Peay, is the homeowner who signed for and accepted the completed warranty service work performed by SEHI under the extended warranty agreement. (Apx. G, R. 150-51, 53).

Later, Appellees raised issues related to the basement and foundation construction performed by the co-defendants below that are not party to this Appeal or Arbitration Agreement, and for which the Peays contracted with directly. (Id. SE0042-43, R. 141-42.) These issues against the co-defendants, Morris and Hayden, are outside the Warranty Agreement with SEHI and were for work not performed by SEHI.

II. PROCEDURAL BACKGROUND

Despite the language calling for binding arbitration and the Arbitration Agreement and Closing Video signed by Brian Peay, Appellees, filed a Complaint against SEHI, and non-appellate party defendants, alleging breach of warranty and demanding damages on or about October 3, 2008. (Complaint, R. 1-7). Specifically, the Peays complain of work they commissioned with the Defendants Jerry Morris Construction and/or Larry Hayden regarding the foundation and plumbing work for the subject home – work for which SEHI was not responsible, and for which SEHI had no contractual relationship with Appellees. Id. Appellant, SEHI, answered on October 29, 2008, raising the Arbitration Agreement of the defense stating that the Peays failed to abide by the terms of the Arbitration Agreement

provisions applying to these claims, and that the claims are barred by the Federal Arbitration Act [“FAA”], 9 U.S.C. §2. ®. 24-30).

On December 10, 2008, SEHI then moved to enforce the Arbitration Agreement between Appellants and SEHI and to compel arbitration pursuant to the FAA, 9 U.S.C. §2 et seq., as to those claims against SEHI. ®. 75-98). This motion was heard by the Daviess Circuit Court on February 27, 2009. (TR 2-27-09 9:31:20-36:40; 10:22:56-10:44:24).

By Order dated March 10, 2009, the Daviess Circuit Court denied the Motion to Compel Arbitration. ®. 337-43, Apx. C). SEHI appealed the Circuit Court order. ®. 351-53). The Kentucky Court of Appeals denied appeal on April 15, 2011. (No. 2009-CA-000657-MR, Apx. A). This Discretionary Review followed. (Apx. B.)

ARGUMENT

I. JURISDICTION AND STANDARD OF REVIEW

Pursuant to CR 76.12(4)(c)(v), this issue has been preserved by the Motion to Compel Arbitration, ®. 75-98), and the Order entered by the Daviess Circuit Court on March 10, 2009. ®. 337-43). This order was immediately appealable pursuant to 9 U.S.C. §16(a)(1)(B), which allows an immediate appeal from an order denying a motion to compel arbitration. See also KRS 417.220; Fayette County Farm Bureau Federation v. Martin, 758 S.W.2d 713 (Ky. App. 1988).

In reviewing an order denying enforcement of an arbitration clause or agreement, a two-fold standard of review is applied. Padgett v. Steinbrecher, 355 S.W.3d 457, 459 (Ky. Ct. App. 2011). See KRS 417.220(2) (“The appeal shall be taken in the manner and to the same extent as from orders or judgments in a civil action.”). First, the appellate court

examines the trial court's findings of fact. Conseco Fin. Servicing Corp. v. Wilder, 47 S.W.3d 335, 340 (Ky.App.2001). Those factual findings are reviewed under the clearly erroneous standard and are deemed conclusive if they are supported by substantial evidence. Id. Second, the circuit court's legal conclusions are reviewed de novo to determine if the law was properly applied to the facts. Id. As there are no disputed issues of fact pertaining to the issue before this Court, the Arbitration Agreement, the appeal should be granted and the Arbitration Agreement enforced on remand.

II. THE COURT OF APPEALS' ERRED IN HOLDING THE ARBITRATION AGREEMENT WAS UNCONSCIONABLE

A. The FAA Controlled the Arbitration Agreement

In the Motion to Compel Arbitration before the trial court, as well as on appeal, SEHI has asserted the FAA controls the arbitration agreement. (See Motion to Compel Arbitration, R. 75-98; Court of Appeals Appellant Br. pp. 7-11). The Peays acknowledged from the institution of their lawsuit that this was a matter affecting interstate commerce. (Complaint, R. 1-7). The home was manufactured in Alabama. (SE0070-71, 74, 88, R. 99-279). It was delivered to a Kentucky corporation, American Dream. (Bill of Lading SE0123, R. 99-279). The Appellees are residents and citizens of the Commonwealth of Kentucky. American Dream then delivered the subject home to Appellee's property in Daviess County, Kentucky. Accordingly, the sale of the manufactured home involved in this matter was by, and among, parties of different states.

The FAA governs arbitration agreements in contracts involving interstate commerce. 9 U.S.C. § 2 ("A contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction ...shall be valid,

irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”) As recognized by the U.S. Supreme Court in Allied Bruce Terminix Co. v. Dobson, 513 U.S. 265, 270 (1995), provisions requiring arbitration over matters involving or affecting interstate commerce are controlled by the FAA, and the reach of the FAA is co-equal with the Commerce Clause. Thus, the FAA preempts the Kentucky Uniform Arbitration Act on issues relating to this arbitration agreement.

This Court recently affirmed the principle that federal law, not Kentucky law, governs arbitration agreements relating to choice of law provisions made pursuant to the FAA. Hathaway v. Eckerle, 336 S.W.3d 83, 87 (Ky. 2011). The primary purpose of the FAA is to ensure the uniform enforcement of arbitration agreements. Allied Bruce Terminix Co. v. Dobson, 513 U.S. at 270; see also Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989). “The effect of the Arbitration Act is thus to create a body of substantive federal law on arbitration governing any agreement that is within the Act's coverage.” Foster v. Turley, 808 F.2d 38 (10th Cir.1986). Thus, the FAA creates uniformity by applying to all cases involving interstate commerce. As this Court noted in Hathaway, citing Ernst & Young, LLP v. Clark, 323 S.W.3d 682, 687 (Ky. 2010), when the FAA applies, “we need not consider Kentucky’s Uniform Arbitration Act,” Id. at 87, and federal interpretation and arbitration principles apply and are controlling in this arbitration contract interpretation.

Contrary to the Kentucky Supreme Court holdings in Hathaway and Ernst & Young, the Court of Appeals reviewed the arbitration agreement solely under the Kentucky Uniform Arbitration Act, KRS 417.050 et seq., rather than the controlling FAA, 9 U.S.C. §2 et seq.

Specifically, the Court of Appeals found the arbitration agreement to be “unconscionable” because it was a contract of adhesion presented by the manufacturer separately from the contract of sale with American Dream. (Court of Appeals Opn. at 5-6, Apx. A).

B. Terms for Warranty and Arbitration Were Offered and Accepted

The agreement and its terms were accepted by Appellees, as evidenced by Mr. Peay’s signature on the Arbitration Agreement and the Closing Video Script. (See Exhibit A.) There is no contention that the writing of the Arbitration Agreement is incomplete, and no parole evidence of contrary terms in the contract is alleged. Despite Appellees’ statements to the Courts below, (Response p 3; R. 183), the June 2006 Arbitration Agreement specifically incorporated into it by reference the earlier contracts, including the purchase agreement for the home signed in November 2005. (Apx. D; R. 94-95). The mutual obligations and rights of SEHI and the Peays were clearly stated. Thus, the contract for arbitration was offered and accepted, as shown by Mr. Peay’s clear signatures, and the contract terms are “full and complete.”

Further, although Appellees are not alleging fraud in the inducement, as they assert no contract exists, the Sixth Circuit’s analysis on parties and contracts is instructive:

Plaintiffs first contend that there was no agreement to arbitrate. However, the record indicates that the parties did agree to arbitrate: the videotape shows Plaintiffs reviewing the documents, engaging in discussions concerning them, and reading them prior to signing. “One who signs a contract is presumed to know its contents, and . . . if he has had an opportunity to read the contract which he signs he is bound by its provisions.” Sears, Roebuck & Co. v. Lea, 198 F.2d 1012, 1015 (6th Cir. 1952). This Court applies “the cardinal rule that, in the absence of fraud or wilful deceit, one who signs a contract which he has had an opportunity to read and understand, is bound by its provisions.” Allied Steel and Conveyers, Inc. v. Ford Motor Co., 277 F.2d 907, 913 (6th Cir. 1960). Plaintiffs seem to argue that there is fraud in the transaction, but point to no actual evidence that either they were deceived into signing

something they believed to be other than an agreement to arbitrate, or that they had not in fact signed the arbitration agreement.

Stout v. J.D. Byrider, 228 F.3d 709, 715 (6th Cir. 2000). The simple facts are: Appellees received the warranty book; signed the Arbitration Agreement contained with it; viewed the Closing Video which further explained arbitration; signed the Closing Video Script containing the additional arbitration clause; and registered the home for extended warranty service. Having had an opportunity to review, having signed, and having ratified the agreement by seeking and receiving warranty work under the warranty agreement, Appellees are now estopped from denying their obligations to arbitrate under this agreement. See Gailor v. Alsabi, 990 S.W.2d 597, 604 (Ky.1999).

C. The Arbitration Agreement Was Not Procedurally Unconscionable

As this Court noted in Schnuerle, et al. v. Insight Communications, Co., et al., – S.W.3d–, 2008-SC-789, 2009-SC-390 (Ky. August 23, 2012), procedural unconscionability focuses on the procedures surrounding the making of the arbitration clause. This requires “unfair surprise” where the clause is buried or hidden through “the use therein of fine print and convoluted or unclear language.... [It] involves, for example, ‘material, risk-shifting’ contractual terms which are not typically expected by the party who is being asked to ‘assent’ to them and often appear [] in the boilerplate of a printed form.” Id. at 25 (quoting Conseco, 47 S.W.3d at 343 n. 22). Relevant factors “include the bargaining power of the parties, ‘the conspicuousness and comprehensibility of the contract language, the oppressiveness of the terms, and the presence or absence of a meaningful choice.’” Id. at 25 (quoting Jenkins v. First American Cash Advance of Georgia, LLC, 400 F.3d 868, 875-76 (11th Cir.2005)). Below, the Court of Appeals focused on the Arbitration Agreement as a “contract of

adhesion.” Court of Appeals Opn. at 5. The Court of Appeals, noted that “the arbitration provision was not presented to the Peays until the closing and was presented by the manufacturer, not the seller.” (Court of Appeals Opn. at 6, Apx. A). The Court of Appeals determined that this made the Arbitration Agreement a condition of the sale of the subject home and not a condition of the extended warranties and therefore was procedurally unconscionable under state common law. Id., see also Dissent at 8-9 (“At closing, Peay received a warranty book from SEHI and signed an agreement attached to the warranty book...”). This conclusion is incorrect.

Kentucky law does not hold that contracts of adhesion are unconscionable *per se*, a legal conclusion affirmed by this Court in Schnuerle. 2008-SC-000789-DG (“Adhesion contracts are not per se improper.”) Nor was the Arbitration Agreement here unconscionable under the standards set forth in Conseco, 47 S.W.3d 335, 343 n. 22, and Schnuerle, at 24. As this Court has recognized, the decision of the U.S. Supreme Court in AT&T Mobility v. Concepcion et ux., – U.S. –, 131 S.Ct. 1740 (2011), precludes enforcement of a state policy invalidating an arbitration agreement upon grounds of unconscionability as an adhesion contract term. Schnuerle, et al, v. Insight Communications, Co., et al, – S.W.3d –, 2008-SC-789, 2009-SC-390 (Ky. August 23, 2012).

The arbitration agreement at issue in Concepcion was a contract of adhesion, as determined by the Court of Appeals in the matter sub judice. However, a finding that an agreement is a contract of adhesion is not determinative. As the U.S. Supreme Court in AT&T Mobility v. Concepcion noted, all consumer contracts are now contracts of adhesion. Id. at 1750. The U.S. Supreme Court reviewed the California rule set out in Discover Bank

v. Superior Court, 36 Cal. 4th 148, 163, 113 P.3d 1100 (2005), which had held that arbitration agreements waiving class action claims were unconscionable at the time made and permitted the consumer to repudiate waivers made by the consumer through the arbitration agreement.

Following an analysis of the FAA and its interaction with state contract principles, the U.S. Supreme Court held that the California unconscionability rule unreasonably interfered with arbitration and with the principles of Congress as set forth in the FAA and held Discover Bank preempted by the FAA. Concepcion, 131 S.Ct. 1753. Similarly, the effect of the Court of Appeals' decision in this matter is to hold that arbitration agreements presented in a contract of adhesion relating to express warranties presented at the time of closing are per se unconscionable. Such a rule effectively disfavors arbitration and is preempted by the FAA:

When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA. Preston v. Ferrer, 552 U.S. 346, 353, 128 S. Ct. 978, 169 L.Ed.2d 917 (2008). But the inquiry becomes more complex when a doctrine normally thought to be generally applicable, such as duress or, as relevant here, unconscionability, is alleged to have been applied in a fashion that disfavors arbitration. In Perry v. Thomas, 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed.2d 426 (1987), for example, we noted that the FAA's preemptive effect might extend even to grounds traditionally thought to exist " 'at law or in equity for the revocation of any contract.' " Id., at 492, n. 9, 107 S.Ct. 2520 (emphasis deleted). We said that a court may not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what ... the state legislature cannot." Id., at 493, n. 9, 107 S.Ct. 2520.

Concepcion, 131 S.Ct. 1747. In light of the U.S. Supreme Court's decision in AT&T Mobility v. Concepcion et ux., SEHI believes the Court of Appeal's decision was in error and should be reversed.

Nor was the Arbitration Agreement procedurally unconscionable under Kentucky law. In this matter, the Agreement with SEHI was not a condition of the earlier Purchase Order with American Dream, nor was it part of the Purchase Order – that was between the Peays and American Dream. Court of Appeals Opn, Dissent at 8. The Arbitration Agreement is contained in a separate express warranty contract between SEHI and the Peays and is distinct from the purchase agreement between American Dream and the Peays. Id. American Dream is not SEHI. Rather, American Dream was a retailer of manufactured homes. In this transaction, SEHI was a wholesale manufacturer. SEHI did not sell the subject home to the Peays, was not a party to the Purchase Agreement between the Peays and American Dream, and was not bound by the terms of that Purchase Agreement.

As in Schnuerle, the Arbitration Agreement here

was not concealed or disguised within the form; its provisions are clearly stated such that purchasers of ordinary experience and education are likely to be able to understand it, at least in its general import; and its effect is not such as to alter the principal bargain in an extreme or surprising way.

Schnuerle v. Insight Communications Co., L.P., 2008-SC-000789-DG at 25-26. Indeed, a cursory review of the Arbitration Agreement shows that its language was conspicuous. (Apx. D, R. 95-96). The agreement began with a larger-font bolded caption, and the definitions and terms were clearly and separately set out. Id. The “effect” of the Arbitration Agreement was not to alter the sale of the home between American Dream and Appellees in any way, rather the Arbitration Agreement was the consideration for a second, separate, agreement between Appellees and SEHI for extended warranty agreements. In short, the Arbitration Agreement is the basis of the principal bargain. Moreover, the Arbitration Agreement was raised to Appellees’ attention three separate times: first when Mr. Peay executed the

Arbitration Agreement on behalf of himself and his wife, second during the Closing Video, and third when Mr. Peay signed the Closing Video Script. (Apx. D, E, R. 95-97). Thus, the Arbitration Agreement is not procedurally unconscionable.

D. The Arbitration Agreement Was Not Substantially Unconscionable

While the Court recognized that substantive unconscionability alone may be grounds for invalidating an arbitration clause, Schnuerle, 2008-SC-000789-DG at 25 n. 12, it is evident that the Arbitration Agreement herein is not substantively unconscionable. “Substantive unconscionability ‘refers to contractual terms that are unreasonably or grossly favorable to one side and to which the disfavored party does not assent.’” Id. (quoting Conseco, 47 S.W.3d at 343 n.22). Considerations include the “commercial reasonableness of the contract terms, the purpose and effect of the terms, the allocation of the risks between the parties, and similar public policy concerns.” Id. (quoting Jenkins v. First American Cash Advance of Georgia, LLC, 400 F.3d 868, 876 (11th Cir. 2005)).

1. The Contract Was Commercially Reasonable

Kentucky recognizes the general requirements of offer and acceptance, full and complete terms, and consideration to establish a binding and enforceable contract. *C.f.* Cantrell Supply, Inc. v. Liberty Mut. Ins. Co., 94 S.W.3d 381, 384 (Ky. App. 2002). The contract with SEHI was under what conditions SEHI would offer express warranties for the subject home, and the consideration the Peays would offer in exchange for such extended warranties and repair work. This consideration by the Peays was the agreement to arbitrate. Kruse v. AFLAC Intern., Inc., 458 F.Supp.2d 375, 385 (E.D.Ky. 2006) (citing Walker v. Ryan's Family Steak Houses, Inc., 400 F.3d 370, 380 (6th Cir.2005)).

2. The Purpose and Effect of the Terms Were the Conditions Under Which Express Warranties Were Granted

Not only did Appellees accept the warranties and the warranty book, they *acted* upon the warranties and accepted warranty service following the closing. (See R 148, 153; and generally SEHI's Response to Requests for Production R 99-279). Specifically, they requested warranty service from SEHI *after* the closing date of June 26, 2006, and received the requested warranty repairs from SEHI. *Id.* The consideration requested by SEHI in return for express warranty service was the arbitration agreement.

3. Mutuality of Obligation Equally Allocates the Risk Among the Parties and is Sufficient Consideration Under Kentucky Law

Moreover, SEHI was also subject to the Arbitration Agreement and Appellees could elect to initiate arbitration. @ 94-95). The Arbitration Agreement states this mutual waiver at least five separate times, including under the section title "**IMPORTANT - JURY WAIVER**". (supra pp. 2-3; Apx. D, R. 94-95). Under the FAA "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) (citing Walker v. Ryan's Family Steak Houses, Inc., 400 F.3d 370, 380 (6th Cir.2005)). In this case, the Arbitration Agreement was signed and initialed by Appellee, and "was neither concealed nor disguised, and its provisions were clearly stated such that the parties would likely to be able to understand it." Kruse, 458 F.Supp.2d at 385; see also Shadeh v. Circuit City Stores, Inc., 334 F.Supp.2d 938, 941 (W.D.Ky., 2004) (holding under Kentucky law that mutuality of obligation is sufficient consideration for arbitration agreement).

4. The Public Policy of Kentucky Favors Enforcement of the Arbitration Agreement

As noted *supra* in subsection 3, both SEHI and Appellees agreed to arbitration and waived their rights to jury trial. (®. 94-95). As this Court stated in Schnuerle,

The arbitration clause in this case is a basic arbitration clause permitting either side to compel arbitration. It has no unique characteristics to distinguish it from any other standard arbitration clause.

Schnuerle, 2008-SC-000789-DG at 28.

Unlike the Court of Appeal's interpretation, this agreement was completely separate from the transfer of the subject home or its affixation to real property and is not extinguished or superceded by a deed in real property. Dress, Co. v. Osburg, 144 S.W.3d 831, 833 (Ky.App. 2003). The Appellees' rejection of the warranty book and the Arbitration Agreement would not have jeopardized the sales agreement between Appellees and American Dream. Appellees could have, as was their right, accepted the subject home under the implied warranty of merchantability. They specifically elected not to do so. Rather, Appellees chose to receive the subject home with written and express warranties that included a warranty term for repairs from SEHI. The consideration requested by SEHI for these written and express warranties was the mutual agreement to arbitrate all claims against SEHI related to the subject home. Appellees purposefully and knowingly accepted the Arbitration Agreement in return for the express warranties. As Appellees have requested and accepted warranty service under this contract, they ratified its terms. Thus the contract, by its terms, controls any dispute concerning SEHI and the Order of the Circuit Court should be reversed.

III. THE COURT OF APPEALS ERRED IN APPLYING THE “MERGER AND INTEGRATION CLAUSE” TO BAR THE LATER ARBITRATION AGREEMENT BETWEEN APPELLEES AND SEHI

Following the closing on June 26, 2006 with American Dream for the subject home, Brian Peay received and executed an agreement with SEHI for warranty service on the subject home. This included the arbitration agreement which was not only set forth in the warranty book, but explained and restated with the closing video and transcript, also signed by Brian Peay. The Peays then sought and received warranty service from SEHI subject to this warranty agreement. As KRS 417.050 and American General Home Equity, Inc. v. Kestel, 253 S.W.3d 543, 550 (Ky. 2008), state, an arbitration agreement is valid and enforceable as a contract and must be enforced unless the contract can be revoked under normal contract principles. As the dissent in the decision below recognized, no such principles exist here. (Court of Appeals Opn., Nickell Dissenting at 8-9.)

Separate from the purchase agreement between Appellees and American Dream in November 2005 or the closing of the sale of the home between those two parties in June 2006, Appellees later entered into a separate agreement with SEHI on June 26, 2006. @. 94-97). The Daviess Circuit Court erroneously held that the merger clause of the 2005 contract precluded Appellees from entering into a later warranty contract regarding the subject home in 2006. The law does not support this ruling. Cox v. Venters, 887 S.W.2d 563, 565 (Ky.App. 1994); U.S. Bond & Mortg. Corp. v. Berry, 61 S.W.2d 293 (Ky. 1933).

At most, the purchase agreement between Appellees and American Dream integrated any verbal negotiations towards purchase of the subject home between Appellees and American Dream into the November 8, 2005 purchase agreement. @. 285). Such merger and

integration clauses do not apply to subsequent separate agreements, such as the June 26, 2006 arbitration agreement between Appellant and Appellees. As the Court of Appeals Dissent noted, no Kentucky authority prevents the Appellees “from entering into a subsequent and separate arbitration agreement with a different party concerning the [subject] home.” (Court of Appeals Opn., Dissent at 9-10.) Parties to a contract may always modify the contract later, or enter into a second contract, even addressing overlapping subject matter. Wilson v. Adath Israel Charitable & Educ. Ass’n Agent, 89 S.W.2d 318, 262 Ky. 55 (Ky. 1935); U.S. Bond & Mortg. Corp. v. Berry, 61 S.W.2d 293. Additionally, as parties who are able to enter contracts are necessarily able to “abrogate or modify them,” written contracts may always be modified, varied, or have specific terms changed or waived through a subsequent contract. See Nat’l Union Fire Ins. Co. v. Duvall, 104 S.W.2d 220, 268 Ky. 168 (Ky. 1937); WH Simmons & Co. v. Price Adm’r, 38 S.W.2d 6, 238 Ky. 332 (Ky. 1931).

As the Dissent noted, the Arbitration Agreement “did not vary the terms between the Peays and American Dream.” (Court of Appeals Opn., Dissent at 10.) The Arbitration Agreement was between SEHI and Appellees, and effected only the acceptance by Appellees of the express warranties offered by SEHI. The Arbitration Agreement was a separate contract supported by mutual consideration and supported by the pro-arbitration policies of the FAA and Kentucky law. Thus, the Circuit Court and Court of Appeals were incorrect as a matter of law in holding that the 2005 contract prevented the formation of the June 26, 2006 Arbitration Agreement.

IV. APPELLEES WERE IN PRIVACY OF CONTRACT WITH SEHI

A. The Appellants Entered Into a Separate Agreement with SEHI for Valid Consideration

As discussed in Section III, supra, Appellees entered into an agreement with SEHI for the provision of extended warranty service. The separate consideration tendered by SEHI for this agreement was to give express warranties regarding the manufactured home and the promise to perform specified repair work under these express warranties. (Apx. D, R. 94-95). The consideration from the Peays in turn was the agreement to arbitrate any disagreement between the Peays and SEHI. Id. There was additional mutual consideration between the two as a mutual obligation to arbitrate is valid consideration for an arbitration agreement. Huff Contracting v. Sark, 12 S.W.3d 704, 707 (Ky. App. 2000); Kruse v. AFLAC Intern., Inc., 458 F.Supp.2d 375, 385 (E.D.Ky. 2006) (citing Walker v. Ryan's Family Steak Houses, Inc., 400 F.3d 370, 380 (6th Cir.2005)).

That a second, separate contract existed is shown by the behavior of Appellees themselves. The Peays requested and received warranty service from SEHI under the express warranty agreement. This included work under warranty on, *inter alia*, November 6, 2006 and November 22, 2006. (Apx. G; R. 148, 153). Appellees cannot, then, claim that no privity of contract existed between them and SEHI to require the Peays to arbitrate their dispute with SEHI under the agreement executed by them.

B. Lori Peay is a Party to the Arbitration Agreement

Lori Peay is a party to the Arbitration Agreement and, contrary to the conclusions of the Court of Appeals and Circuit Court, is bound by its terms. Appellee Lori Peay is asserting claims against SEHI as a party Plaintiff-Appellee, but denies that she is bound by

any contract with SEHI entered into by her husband. Contrary to this position with regards to the Arbitration Agreement, both Appellees have consistently asserted that Lori Peay is a party to the Purchase Order and contract with American Dream. (See Plaintiffs' Response, R. 278-283):

It is further stated that Plaintiffs purchased a home from American Dream Housing, Inc. (copy of the [November 8, 2005] Purchase Order attached hereto and incorporated by reference), not [emphasis original] SEHI. The Purchase Order, in its own language, reflects the fact that Plaintiffs purchased the home from American Dream Housing, Inc., and not Defendant, Energy Homes, a division of Southern Energy Homes, Inc.

(Plaintiffs' Response, R. 278-83) (emphasis added). As the November 2005 Purchase Order attached to Plaintiffs' Response shows, Lori Peay did not sign that document. Yet, Lori Peay has consistently claimed the benefit of the contract she did not sign. This salient fact was noted by the Dissent, yet ignored by the majority and the Appellees alike. (Court of Appeals Opri. at 12.) Likewise, Lori Peay has claimed the benefit of the Arbitration Agreement with SEHI, yet attempted to repudiate the reciprocal obligations. (Apx. G). Her position is both disingenuous and contrary to the laws of this Commonwealth.

She cannot claim privity as both a sword and shield. If she denies privity with SEHI on the basis that she is not a signatory to the Arbitration Agreement, then she has no personal claim against SEHI. If she asserts, as she does in the complaint, a personal interest in damages against SEHI including work covered by the express warranty agreement entered into by Brian Peay, then she as adopted and ratified his signature on her behalf. As Judge Nickells wrote in his Dissent: the Appellees "desire to 'have their cake and eat it too.'" Court of Appeals Opn., Dissent at 14.

Although Mrs. Peay was not a signatory to the purchase agreement, Arbitration Agreement, or Closing Video Script, she is specifically bound by Brian Peay's, her husband's, signature on the arbitration agreement. Kruse v. AFLAC Intern., Inc., 458 F.Supp.2d 375, 382-83 (E.D. Ky. 2006). While not controlling, the Sixth Circuit Court of Appeals has held that a party does not have to personally sign an agreement to be bound, but may stand in the shoes of the entity that signed the agreement. See Javitch v. First Union Sec., Inc., 315 F.3d 619, 625 (6th Cir.2003). Non-signatories to arbitration agreements may be bound to an arbitration agreement under ordinary contract and agency principles. Id. at 629; Arnold v. Arnold Corp., 920 F.2d 1269, 1281-82 (6th Cir.1990). In this case, given the assertions of Mrs. Peay in the Complaint, and her actions under the express warranty agreement, Brian Peay was acting as her authorized agent at the time he executed Arbitration Agreement.

"It is well established that a third person may, in his own right and name enforce a promise made for his benefit even though he is a stranger both to the contract and to the consideration." Presnell Const. Managers, Inc. v. EH Const., LLC, 134 S.W.3d 575, 579 (Ky. 2004). Lori Peay is such a beneficiary. As this Court recognized in Ping v. Beverly Enterprises, Inc., 2010-SC-000558-DG, 2012 WL 3631399 (Ky. Aug. 23, 2012), Kentucky law permits a third party beneficiary asserting rights under the contract is subject to any defense that the promisor would have against the promisee. Schneider Moving & Storage Co. v. Robbins, 466 U.S. 364, 370, 104 S.Ct. 1844, 80 L.Ed.2d 366 (1984) (citing Restatement (Second) of Contracts § 309, cmt. b (1981); S. Williston, Contracts § 395 (3d ed.1959); and 4 A. Corbin, Contract § 819 (1951)). The Ping Court went on to state:

This general rule is widely deemed to extend to arbitration clauses: “[W]here [a] contract contains an arbitration clause which is legally enforceable, the general rule is that the beneficiary is bound thereby to the same extent that the promisee is bound.” Benton v. Vanderbilt University, 137 S.W.3d 614, 618 (Tenn.2004) (quoting from Williston on Contracts § 364 A (3d ed.1957) and collecting cases).

Ping, supra at 21 (emphasis added).

Ping recognized that this rule favoring third-party application of arbitration agreements has been applied in nursing home cases where, even though the principal’s agent did not have authority to bind the principal as a party to the arbitration clause, the agent entered the admissions agreement not merely as a purported representative but also in his or her individual capacity, and the decedent, and hence the estate, has been deemed bound by the arbitration clause as a third party beneficiary of the contract between the facility and the agent. Ping, supra at 21 (citing Cook v. GGNCS Ripley, LLC, 786 F.Supp.2d 1166 (N.D.Miss.2011); THI of New Mexico at Hobbs Center, LLC v. Patton, 2012 WL 112216 (D.N.M.2012)).

Here, unlike the plaintiff in Ping, Brian Peay clearly entered the Arbitration Agreement “not merely as a purported representative but also in his [] individual capacity.” Ping at 21. Furthermore, his intent to bind Lori Peay to the extended warranty agreement and Arbitration Agreement is clear by Lori Peay’s ratification of these agreements through later actions. Lori Peay requested and signed off on service under the extended warranties in 2006. (SEHI Response to Request for Production SE0051-52, 54; R. 150-51,53, Apx. G).

C. Lori Peay Ratified the Arbitration Agreement by Seeking Extended Warranty Services

As noted above, Appellees requested warranty service under the express warranties they received from SEHI. (Apx. G, R. 150-51, 53). Specifically, Appellees requested warranty service from SEHI under the express warranty agreement. They received the requested warranty service from SEHI under the agreement. *Id.* This included work under warranty on, *inter alia*, November 6, 2006 and November 22, 2006. (See Apx. G). These service requests were made after the closing on the subject home and after the execution of the Arbitration Agreement by Appellees. *Id.* Although it has already been established that a valid and enforceable contract existed prior to this warranty service - offer, acceptance, and consideration through the express warranties and mutuality of obligation - Lori Peay has ratified the warranty and Arbitration Agreement through her acceptance of warranty service for which the Arbitration Agreement was due consideration. (Apx. D, R 95-96).

A party cannot seek to avoid arbitration yet enforce other portions of the agreements between the parties. Thus, regardless of her status as a signatory of the Arbitration Agreement on June 26, 2006, Lori Peay's own actions show that she was an intended beneficiary and intended obligor under the Agreement. *C.f. Clark v Thompson*, 219 S.W.2d 22 (Ky, 1948) (holding that even when contract was allegedly induced by fraud, a party may not ratify part of a contract without ratifying all of it); *J.I. Case Threshing Mach. Co. v. Dulworth*, 287 S.W. 994 (Ky. 1925) (infant's rescision of a contract must be *in toto*); *Stewart v. Mitchell's Adm'x*, 190 S.W.2d 660 (Ky. 1945) (one may not accept fruits of a business deal and at the same time disclaim responsibility for measures by which they were acquired).

Thus, Lori Peay has accepted the benefits of the warranties given in consideration of the Arbitration Agreement. This constitutes acceptance of the Arbitration Agreement itself. Since she accepted the benefits, she must be bound by the conditions, and the Arbitration Agreement must be enforced as to her, as well as her husband and agent Brian Peay.

As Appellees have requested and accepted warranty service under this contract, they ratified its terms; their consideration was the agreement to arbitrate as reduced to writing in the Arbitration Agreement and executed by Appellees. Thus, the contract, by its terms, controls any dispute concerning SEHI resulting from the manufacture, sale, and/or later repair under warranty service of the subject home. (Apx. D, R. 94-95).

D. The Scope of the Arbitration Agreement Encompasses Appellees' Claims

The scope of the Arbitration Agreement between Appellees and SEHI specifically encompass Appellees' claims here. Federal law interpreting the FAA has held that arbitration agreements are as broad as the Commerce Clause itself. *See Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 274 (1995). Any doubts considering the scope of arbitrable issues are resolved in favor of arbitration. *See Bratt Enterprises, Inc. v. Noble International Limited*, 338 F.3d 609, 610 (6th Cir. 2003) and *Dean Witter Reynolds, Inc. v. Byrd*, 470 US 213, 218, 105 S.Ct. 1248 (1985). Here, Appellees' claims in tort, breach of contract, and warranty are clearly covered under the arbitration agreements.

The Arbitration Agreement specifically notes that *both parties* are bound by arbitration – the mutuality of obligation. (Apx. D, R. 94-95). The Arbitration also states that Appellees and SEHI “agree to arbitrate any and all claims and disputes arising from or relating to the Contract, the Manufactured Home, . . . the design and construction of the

Manufactured Home, . . . and any and all other disputes between You and Us.” (Apx. D, R. 94-95). As a general rule, “Kentucky law favors arbitration agreements.” Mortgage Electronic Registration Systems, Inc. v. Abner, 260 S.W.3d 351, 353 (Ky.App. 2008). KRS 417.050 provides in pertinent part that “[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[.]” The FAA provides similar support for arbitration of “any” controversy “arising from” the subject manufactured home.

All of Appellees’ claims against SEHI “arise[] from or relate[] to” the design and construction of the subject home, warranties, or warranty repair work. (Complaint, R 1- 7; Apx. D, R. 94-95). Thus, all of Appellees’ claims are encompassed by the Arbitration Agreement and must be submitted to binding arbitration, and the decision of the Daviess Circuit and the Court of Appeals to deny arbitration was in error.

V. THE DAVIESS CIRCUIT COURT ERRED IN NOT ORDERING ARBITRATION

Having shown that the arbitration provisions and the Federal Arbitration Act apply, the Daviess Circuit Court should have compelled Appellees to arbitrate the action, and stayed the Daviess Circuit Court action against SEHI until disposition of the arbitration. (R. 75-98, 337-43) This Court has the power to correct this error.

The Federal Arbitration Act, 9 U.S.C. §3 states:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the

action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

This action itself raised arbitration from its inception and is an action to compel arbitration under 9 U.S.C. §4.

As this is under the FAA, federal law controls. *See Saneii v. Robards*, 289 F.Supp.2d 855, 858 (W.D. Ky. 2003). Once the court has determined the issue of arbitration, the action required to be stayed under 9 U.S.C. §3.

It is settled authority that doubt regarding the applicability of an arbitration clause should be resolved in favor of arbitration. *See, e.g., Moses H. Cone Memorial Hosp. V. Mercury Const. Corp.*, 460 U.S. 1, 24-25, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983); *Ferro*, 142 F.3d at 932. If parties contract to resolve their disputes in arbitration rather than in the courts, a party may not renege on that contract absent the most extreme circumstances. *See Southland Corp. v. Keating*, 465 U.S. 1, 24, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984); *Dean Witter Reynolds, Inc. v. McCoy*, 995 F.2d 649 (6th Cir. 1993). A district court's duty to enforce an arbitration agreement under the FAA is not diminished when a party bound by the agreement raises claims arising from statutory rights.

Stout v. J.D. Byrider, et al, *supra* at 715. “[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration,’ and thus, ‘any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.’” *Williams v. Imhoff*, 203 F.3d 758, 764 (10th Cir. 2000) (quoting *Armijo v. Prudential Insurance Company of America*, 72 F.3d 793, 797 (10th Cir. 1995), also quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626, 105 S.Ct. 3346 (1985)).

Under the FAA, the Court first must determine whether the parties agreed to arbitrate and the scope of the arbitration. Having properly found an arbitration agreement, the Court then is required to stay all proceedings, including discovery, pending the arbitration. *See, Mehler v. Terminix International Co. LP*, 205 F.3d 44 (2d Cir. 2000); *Williams v. Imhoff*,

supra. “If the issues in the case are within the contemplation of the arbitration agreement, the FAA’s stay-of-litigation provision is mandatory, and there is no discretion vested in a [trial] court to deny the stay.” United States v. Bankers Insurance Co., 245 F.3d 315, 319 (4th Cir. 2001) (emphasis added); *see also*, Houlihan v. Offerman & Co., Inc., 31 F.3d 692 (8th Cir. 1994). Any remaining issues regarding the interpretation of the arbitration agreement are reserved to the arbitrator under 9 U.S.C. §1 *et seq.* and Prima Paint Corp., 388 U.S. at 403-04.

As is clearly shown by the record from the Daviess Circuit Court, the Appellees and SEHI agreed to arbitrate under the FAA any and all claims arising from the design, manufacture, and sale of the subject home. As the subject home was involved in interstate commerce, the FAA is the controlling law in this dispute. As the arbitration agreement was valid and the claims raised in Appellees’ Complaint are within the scope of the Arbitration Agreement, the Daviess Circuit Court lacked discretion to deny the requested stay and order to compel arbitration. Thus, the decisions below were in error.

CONCLUSION

The Appellees entered into a valid Arbitration Agreement with SEHI on June 26, 2006. This agreement was supported by consideration in the form of express warranties for the subject home, and in the mutuality of the obligation imposed through the Arbitration Agreement. These warranties, and therefore the accompanying Arbitration Agreement, were affirmatively accepted by both Lori and Brian Peay under ordinary contract principles and this Court’s holdings in Ping v. Beverly Enterprises, Inc., 2010-SC-000558-DG, 2012 WL 3631399 (Ky. Aug. 23, 2012). Further, as recognized by the U.S. Supreme Court in AT&T

Mobility v. Concepcion et ux., – U.S. –, 131 S.Ct. 1740 (2011), and this Court in Schnuerle, et al, v. Insight Communications, Co., et al, – S.W.3d –, 2008-SC-789, 2009-SC-390 (Ky. August 23, 2012), this Arbitration Agreement is an ordinarily accepted agreement that is not unconscionable in any manner. Finally, the “merger” clause in the November 8, 2005 Purchase Order does not operate as a matter of law to exclude or invalidate any later contract between the Peays and SEHI for warranty service regarding the subject home - it merely integrates other agreements between SEHI and American Dream, the only parties to the Purchase Order.

The Arbitration Agreement expressly encompasses the Appellees’ claims against SEHI within its scope and terms. As the subject home affects interstate commerce, the Federal Arbitration Act is the controlling law in this matter. The FAA mandates that, when a valid arbitration agreement exists, as does here, and the FAA applies, the Circuit Court must stay the matter and refer it to arbitration. As such, the Daviess Circuit Court erred in its Order of March 11, 2009 when it denied the Motion to Compel Arbitration and denied the entry of a stay pending arbitration. Respectfully, as a matter of law, the Order of March 11, 2009 must be reversed and an order compelling arbitration of the Appellees’ claims against SEHI should be entered.

Respectfully submitted,

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APPENDIX

- A. Opinion of the Court of Appeals, No. 2009-CA-000657-MR
- B. Order granting discretionary review
- C. Opinion of Daviess Circuit Court, (R. 337-43)
- D. Exhibit A to the Affidavit of Don McNutt (R. 94-95)
- E. Exhibit B to the Affidavit of Don McNutt (R. 96-97)
- F. Exhibit C to the Affidavit of Don McNutt (R. 98)
- G. SEHI Response to Request for Production SE0051-52, 54 (R. 150-51, 153)
- H. Schnuerle, et al, v. Insight Communications, Co., et al, – S.W.3d –, 2008-SC-789, 2009-SC-390 (Ky. August 23, 2012)
- I. Ping v. Beverly Enterprises, Inc., 2010-SC-000558-DG, 2012 WL 3631399 (Ky. Aug. 23, 2012)