

## Does an Arbitration Provision Survive an Unenforceable Contract?

**Judge Abraham J. Gafni (Ret.)**

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That the Federal Arbitration Act (FAA), state arbitration statutes and courts generally favor arbitration provisions in contracts is well-recognized. But what if the contract containing the arbitration agreement appears on its face to be invalid, unenforceable and against public policy under state law? Will the arbitration provision similarly be deemed unenforceable? Or will the arbitration provisions, nonetheless, remain valid and enforceable, resulting in the arbitration of the dispute?

This issue was considered by the Court of Appeals of Georgia in *Juhn v. Imagine Castle*, 358 Ga. App 627 (2021).

The case involved the Juhns hiring Imagine Castle to perform remodeling, structural and other work in their house. The initial contract was later amended to include an arbitration agreement. It provided:

“Any ... claim or dispute of any kind or nature between contractor/builder and homeowner/buyer arising out of or relating in any manner to this agreement or this transaction ... shall be decided by binding arbitration.” It further provided that “any questions regarding the interpretation of this arbitration provision or about the arbitrability of a dispute ... shall be decided by the arbitrator.” In addition, it recited that the FAA would govern the arbitration.

Subsequently, the Juhns contended that after work had commenced, Imagine Castle provided shoddy and incomplete work that was not compliant with requisite building codes, ordinances and industry standards and was billing them for materials that had not been ordered and work that had not been completed. The Juhns eventually stopped paying Imagine Castle and hired other contractors to complete the work.

The Juhns sued Imagine Castle and their principals in the Georgia state court for damages arising out of the allegedly defective work. In addition, they specifically asked the state court to declare the contract unenforceable and void as a matter of public policy because Imagine Castle was not a properly licensed contractor.

The Juhns, in their complaint, further stated that one principal of Imagine Castle, had represented that he was a properly licensed contractor. In their answer to the complaint, Imagine Castle and its principals admitted that none of them was properly licensed.

Imagine Castle then moved to compel arbitration in the matter based on the arbitration provisions in the contract.

The Juhns opposed this motion on the ground that the entire contract, including the arbitration provisions, was unenforceable under Georgia law because the contractor and its principals were admittedly not licensed. The Juhns contended that under Georgia law, any contractors who are unlicensed cannot enforce a contract. That law provides:

“As a matter of public policy, any contract entered into ... for the performance of work for which a residential contractor or general contractor license is required ... and which is between an owner and a contractor who does not have a valid and current license required for such work ... shall be unenforceable in law or in equity.”

Nonetheless, the trial court granted the motion to compel arbitration, concluding that the enforceability of the contract was for the arbitrator to decide.

The Juhns appealed this ruling, contending that allowing an unlicensed contractor to enforce an arbitration provision in a housing contract would be contrary to Georgia public policy under the statute quoted above.

In considering the matter on an interlocutory appeal, the Georgia Court of Appeals disagreed with the Juhns, referencing the FAA as well as decisions of the state court and the U.S. Supreme Court.

The court of appeals recognized that under the FAA, “where there is a specific challenge attacking the validity of an arbitration agreement, the court and not the arbitrator should decide whether the arbitration provision is enforceable.” However, it further noted, that “a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator.”

Here the Juhns had not alleged any specific challenge to the arbitration agreement itself. Their challenge to the arbitration agreement was only “part and parcel of their argument that the entire agreement is unenforceable due to the defendants’ unlicensed status.”

Under “standard FAA arbitration law,” therefore, as this was a challenge to the entirety of the contract itself, it must be resolved by the arbitrator.

The Juhns contended, however, that the FAA rule should not here apply because the Georgia statute specifically states that any contract entered into by an unlicensed contractor is “unenforceable.” They insisted that the admittedly unlicensed contractor

should not be able to enforce any part of the agreement, including the arbitration provisions; and that allowing it to enforce those provisions would defeat the public policy established by the legislature to protect homeowners.

The Georgia Court of Appeals found this position to be unsupportable under state law. In earlier cases (e.g., involving loan contracts), Georgia courts had affirmed orders to arbitrate, notwithstanding a party's argument that the contract itself was unenforceable or void as against public policy. The basis for these holdings: whether a contract is illegal, unenforceable or against public policy (including even if, as here, the contractors acknowledged that they were unlicensed) is for an arbitrator, and not the court, to decide.

The Georgia Court of Appeals found further support for this position in the Supreme Court's decision in *Buckey Check Cashing v. Cardegna*, 546 U.S. 440 (2006). There, the court had similarly found that a challenge to a contract that was allegedly void under the law of Florida, did not render the arbitration provision in that contract unenforceable.

The Supreme Court there explained: "First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. Second, unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance. Third, this arbitration law applies in state as well as federal courts. ... Therefore, because the respondents challenge the agreement, but not specifically the arbitration provisions, those provision are enforceable apart from the remainder of the contract."

Thus, the Supreme Court rejected the contention that "enforcement of an otherwise valid arbitration agreement contained within an unenforceable contract could turn on an individual state's law or public policy." Rather, the court required that courts consider separately the substantive provisions and the arbitration provisions in the agreement. It recognized that such a ruling might permit a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void. Conversely, however, this might also allow a court to deny effect to an arbitration agreement in a contract that is later found by a court to be enforceable.

In short, the Georgia Court of Appeals recognized that the Juhns had correctly argued that the state legislature had established a clear, strong public policy to safeguard homeowners against faulty, inadequate, inefficient and unsafe residential contractors who are unlicensed. However, the FAA, the legislature and the U.S. Supreme Court have a strong and equally clear public policy in favor of requiring the arbitrator—and not a court—to determine the enforceability of a contract as a whole.

Accordingly, the Juhns' argument against the enforceability of the arbitration provisions was rejected because they had failed to raise any specific challenge to them.

Parties, therefore, must be careful to recognize that the arbitration and other provisions in a contract are separate agreements that the courts will consider independently. In particular, notwithstanding infirmities in other parts of the contract, if the arbitration provisions were knowingly and voluntarily made, courts will generally enforce them. They will be denied only on the basis of a meritorious attack on their validity themselves without regard to the validity or enforceability of the other portions of the contract. •

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