NOTE

TEXAS SUPREME COURT DISCUSSES ARBITRATION, DIRECT-BENEFITS ESTOPPEL, AND BREACH OF WARRANTY

Lennar Homes of Texas Land and Construction, Ltd. and Lennar Homes of Texas Sales and Marketing, Ltd. v. Kara Whiteley, ___ S.W. 3d, ___, (Tex. 2023).
https://law.justia.com/cases/texas/supreme-court/2023/21-0783.html

The Supreme Court of Texas recently held that a subsequent purchaser of a home is bound by an arbitration clause in the purchase-and-sale agreement between the builder and the original purchaser.

Cody Isaacson, the purchaser of a Galveston, Texas home signed a purchase-and-sale agreement ("PSA") with the builders, Petitioners Lennar Homes of Texas Land and Construction, Ltd. and Lennar Homes of Texas Sales and Marketing Ltd. (together "Lennar") in May 2014. The PSA incorporated by reference the terms of Lennar's warranty booklet (the "Limited Warranty"), stating that Lennar was making only those express limited warranties set forth in the Limited Warranty, and disavowed any other warranties. Additionally, the PSA contained disclosures about the home including an Environmental Quality Disclosure concerning the likelihood of mold growth.

Finally, and most importantly in the instant case, the agreement contained two arbitration provisions. First, in the PSA the purchaser generally agreed to arbitrate any disputes in accordance with the American Arbitration Association's Home Construction Mediation Procedures ("the AAA rules.") This clause provided that the agreement was made on behalf of the purchaser's children and other occupants of the home with the intent that all such parties would be likewise bound. Second, the purchaser agreed to resolve all warranty disputes pursuant to the dispute settlement provisions provided by the Limited Warranty. Like the PSA, the Limited Warranty provided for arbitration of disputes in accordance with the AAA rules.

Lennar executed and recorded a Special Warranty Deed conveying title to the home and underlying property to Isaacson subject to "[a]ny and all restrictions, encumbrances, easements, covenants, conditions, outstanding mineral interests held by third parties, and reservations" for the property that had been recorded in the County Clerk's office, and also subject to an arbitration provision similar to the PSA and Limited Warranty. The attached provision specifically provided that it "shall run with the land and be binding upon the successors and assigns of" Isaacson.

Isaacson sold the property to Kara Whiteley about a year later, on July 31, 2015, conveying title through a General Warranty Deed that Isaacson executed and recorded in the county records. Whiteley later noticed a mold problem in the home. Whiteley provided notice to Lennar and participated in settlement negotiations, but ultimately sued Lennar on March 1, 2017. Whiteley asserted claims for negligent construction and breach of the implied warranties of habitability and good workmanship and sought actual damages.

Lennar filed to stay proceedings pending arbitration. Lennar argued that the PSA and Limited Warranty required Whiteley to arbitrate her disputes. Whiteley, however, argued that she was not a party to either agreement so was not bound under their terms. Lennar responded that: (1) Whiteley was Isaacson's successor and, under direct-benefits estoppel or because she assumed Isaacon's obligations under the PSA, Whiteley was bound to arbitrate her disputes; and (2) the court should refer questions of arbitrability to the arbitrator because the arbitration clauses incorporate AAA rules. The trial court granted Lennar's motion to stay and the parties proceeded to arbitration. The arbitrator issued an award in favor of Lennar.

The trial court vacated the arbitration award against Whiteley. Lennar appealed, and the court of appeals affirmed.

Subsequently, the parties returned to the trial court. Lennar filed a motion to confirm the arbitration award in its favor, and Whiteley filed a combined motion for the court to deny Lennar's request and vacate the arbitration award. In response, Lennar argued that Whiteley waived her objection to arbitration by failing to object to the arbitrator's jurisdiction during the arbitration proceedings, and that Whiteley was estopped from denying that she is subject to the PSA's arbitration provisions.

The trial court vacated the arbitration award against Whiteley. Lennar appealed, and the court of appeals affirmed. The court of appeals held that: (1) the attached arbitration clause was not a covenant running with the land because it does not "touch and concern" the land; (2) Whiteley did not assume the Special

Warranty Deed's arbitration agreement when she purchased the land; (3) Whiteley was not bound to arbitrate as a third-party beneficiary of the Limited Warranty; (4) direct-benefits estoppel does not apply to claims for breach of the implied warranties of good workmanship or habitability; and (5) Whiteley did not waive her objection to arbitration. The Supreme Court of Texas granted Lennar's petition for review.

Lennar argued to the Supreme Court that: (1) direct-benefits estoppel applied to estop Whiteley from avoiding the PSA's arbitration clause; (2) the arbitration clause attached to Isaacson's Special Warranty Deed was a covenant running with the land; or (3) Whiteley could be compelled to arbitrate as a third-party beneficiary of Lennar's Warranty. Alternatively, Lennar again asserted that Whiteley waived her objection to arbitration.

The court recognized that if a plaintiff's claims are based on a contract containing an agreement to arbitrate, the plaintiff may be compelled to arbitrate its claims even as a non-signatory to the contract. *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 739 (Tex. 2005); *see also In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 755 (Tex. 2001) ("[A] litigant who sues based on a contract subjects him or herself to the contract's terms."). If a non-signatory plaintiff "seeks, through the claim, to derive a direct benefit from the contract," direct-benefits estoppel applies, and the plaintiff may be compelled to arbitrate. *Kellogg*, 166 S.W.3d at 741. To determine whether a claimant seeks to derive a direct benefit from the contract, courts generally look at whether the claim arises from a term of the contract or if it arises from general obligations imposed by law. *In re Vesta Ins. Grp., Inc.*, 192 S.W.3d 759, 761 (Tex. 2006). The Texas Supreme Court held that for direct-benefit estoppel to apply, "the claim must depend on the existence of the contract . . . and be unable to stand independently without the contract." *G.T. Leach Builders, LLC v. Sapphire V.P., L.P*, 458 S.W.3d 502, 527-28 (Tex. 2015) (quotation marks omitted).

The Texas Supreme Court held that for direct-benefit estoppel to apply, "the claim must depend on the existence of the contract . . . and be unable to stand independently without the contract."

Whiteley argued that direct-benefits estoppel did not apply because implied warranty claims derive from common law and the purchase of her home occurred through a separate contract with Isaacson, not the PSA. The Court rejected Whiteley's arguments.

The Court disagreed with Whiteley's argument that the implied warranty claims were not part of the PSA because they derive from common law. Instead, the Court pointed to its previous statement that "a warranty which the law implies from the existence of a written contract is as much a part of the writing as the express terms of the contract." *Certain-Teed Prods. Corp. v. Bell*, 422 S.W.2d 719, 721 (Tex. 1968). Because the implied warranties are considered part of the contract, they would not arise without the contract. Therefore, Whiteley's warranty claims would not exist without the PSA, and direct-benefits estoppel requires Whiteley to arbitrate her claims.

Further, even though the implied warranties of good workmanship and habitability do arise from common law, none of Whiteley's breach of warranty arguments can be evaluated without reference to the PSA. The court first noted that, although parties may not "disclaim this warranty outright, an express warranty in their contract can fill the gaps covered by the implied warranty and supersede it if the express warranty specifically describes the manner, performance, or quality of the services." *Gonzales v. Sw. Olshan Found. Repair Co.*, 400 S.W.3d 52, 59 (Tex. 2013). Because the implied warranty of good and workmanlike performance may be supplanted by the contract, it is necessary to review the contract to determine if the warranty claims exist.

> "In other words, although liability arises in part from the general law, nonliability arises from the terms of the express warranties described in Lennar's '1-2-10 Single-Family Warranty,' which the PSA incorporated by reference."

Accordingly, the warranty of good and workmanlike performance claim does not stand without reference to the parties' contract.

Similarly, the implied warranty of habitability cannot be determined apart from the PSA. The court noted that the PSA included: (1) a general disclaimer of the warranty of habitability, 2) a section of disclosures regarding the home, (3) an Indoor Environmental Quality Disclosure concerning the likelihood of mold growth in the home, and (4) Lennar's "1-2-10 Single-Family Warranty." Arguably, whether those provisions of the PSA were sufficient to negate any implied warranty of habitability with respect to mold growth will depend on the particulars of Lennar's express disclosures. The court concluded that "the implied warranty of habitability does not "arise[] solely from" the PSA, Lennar's liability still "must be determined by reference to it."

In conclusion, the court found that the implied warranties cannot be established independently from the contract and therefore direct-benefits estoppel cannot be used to defeat the arbitration clauses.

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