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Texas Supreme Court Rules That Subsequent Purchaser of Home Is Bound by Original Homeowner's Arbitration Agreement With Builder

In a new opinion *Lennar Homes of Texas Land and Construction, Ltd., et al. v. Kara Whiteley*, Cause No. 21-0783, 66 Tex. Sup. Ct. J. 8740, issued May 12, 2023, the Texas Supreme Court partially reversed two lower court decisions and held that an arbitration provision contained in the original homeowner's contract with the builder was binding on a subsequent homeowner. In the decision, the court found that Kara Whiteley—the second owner of the home in Galveston, Texas—was bound to arbitrate her construction defect claims with Lennar by virtue of the doctrine of “direct-benefits estoppel.” The rationale was based on the fact that Whiteley was seeking benefits emanating from Lennar's contract with the original homeowner.

The residence in question was first purchased from Lennar in May 2014. Whiteley purchased the home in July 2015. The original contract documents included several arbitration provisions—one in the Purchase and Sale Agreement, one in the Limited Warranty issued by Lennar, and one in the general warranty deed. Whiteley sued Lennar in Galveston County District Court alleging mold growth and other defects at the property. Lennar moved for arbitration and its motion was granted. The parties arbitrated the case and Lennar received an award in its favor. Lennar then moved the District Court to confirm the arbitration award, and Whiteley filed a cross-motion to vacate the award, arguing that Lennar's original motion to compel arbitration should not have been granted. The District Court agreed with Whiteley, vacating the arbitration award. Lennar appealed. The Court of Appeals affirmed the District Court's vacatur, and Lennar appealed to the Texas Supreme Court.

While several issues were presented on appeal, the issue that swayed the Supreme Court to rule in Lennar's favor was the legal doctrine of direct-benefits estoppel. Under this doctrine, a party who was not a signatory to an arbitration agreement may be compelled to arbitrate if its claims are “based on a contract” containing an agreement to arbitrate. Non-signatories are not bound to arbitrate if liability arises from “general obligations imposed by law” and the claim can “stand independently without the contract.” *Whiteley*, p. 12. However, when liability arises from the contract or must be determined by reference to it, the non-signatory will be bound to it by equity. *Whiteley*, p. 12.

Whiteley argued that direct-benefits estoppel was inapplicable because she asserted common law implied warranty claims—not contract-based claims—and her purchase of the home was through a contract with the first homeowner, not from Lennar through the Lennar Purchase and Sale Agreement. The Supreme Court rejected Whiteley's arguments for two reasons. First, the court held that, as it had noted in previous cases, although implied warranties derive from the common law, “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.” *Whiteley*, p. 14. Since the builder's obligation arises from a contract, absent a contract, the warranty would not arise. Second, the court held that even if liability arises in part from common law, nonliability (i.e., defenses raised by Lennar) must be determined by reference to the contract. For example, whether Lennar's express limited warranty superseded implied warranties; whether Lennar effectively disclaimed the implied warranty of habitability; whether Lennar's liability was limited by disclosures in the contract, including disclosures related to the likelihood of mold growth. Because Lennar's liability or *nonliability* must be determined by reference to the contract, the court held that Whiteley's claims do not “stand independently” of Lennar's Purchase and Sale Agreement. *Whiteley*, p. 18.

The opinion also reinforced two additional concepts that are particularly helpful to homebuilders. First, the court cited one of its prior opinions for the proposition that a second homeowner “cannot obtain a greater warranty than that given to the original purchaser.” *Whiteley*, p. 16. (Litigants often ignore express limited warranties and try to impose expanded obligations on homebuilders under a common law implied warranty theory.) Second, the court stated that it will look at the substance of a claim, not “artful pleading,” in evaluating whether a claimant seeks a benefit from a contract. *Whiteley*, p. 13. In other words, homeowners cannot plead-around the contract and the warranty to try to avoid them; courts are to look at the substance of the claim and not how the plaintiff has chosen to plead it.

While *Whiteley* concerned application of an arbitration agreement, its holding may have implications in warranty law as well. Limited warranties, like arbitration provisions, are bargained-for and part of the contract with the original purchaser and are often incorporated into and referenced by the contract. The typical limited warranty issued to a purchaser of a new home affects a homebuilder’s *nonliability*, as the *Whiteley* court discussed. *Whiteley*’s analysis of arbitration provisions supports the argument that a subsequent homeowner cannot avoid application of an express limited warranty by disregarding it and pleading breach of common law warranties instead.

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