STATE OF MICHIGAN

COURT OF APPEALS

GARDELLA HOMES, INC.,

Plaintiff/Counter-Defendant-Appellant,

v

JAMES LAHOOD-SARKIS and DANIELLE LAHOOD-SARKIS,

Defendants/Counter-Plaintiffs/Third-Party Plaintiffs-Appellees,

and

RAYMOND GARDELLA and SEAN D. GARDELLA,

Third-Party Defendants-Appellants.

UNPUBLISHED
October 11, 2011

No. 298332
Oakland Circuit Court
LC No. 2009-102368-CK

Before: MURPHY, C.J., and TALBOT and MURRAY, JJ.

PER CURIAM.

Gardella Homes, Inc. (GHI) filed this action against James and Danielle LaHood-Sarkis (the "LaHoods") for breach of a promissory note. The LaHoods filed a counter-complaint against GHI and a third-party complaint against GHI's officers, Raymond Gardella and Sean D. Gardella (the "Gardellas"), alleging various contract, tort, and statutory claims relating to the construction of a house by GHI for the LaHoods. GHI and the Gardellas appeal as of right from the trial court's order directing that all claims, counterclaims, and third-party claims be submitted to arbitration.[1] We vacate the trial court's order and remand for further proceedings.

[1] MCL 600.5001 *et seq.*

I. BASIC FACTS AND PROCEDURAL BACKGROUND

In June 2006, GHI and the LaHoods entered into a contract for GHI to construct a residence on the LaHoods' property. The contract specified how the parties were to proceed once a conditional or final certificate of occupancy was issued and the property was ready for occupancy, but minor details still needed to be completed. It provided that GHI or the LaHoods could prepare a work order for unfinished items and the cost of completion, and further provided:

> a. Completion of the items specified in such work order shall constitute full performance of this Agreement by the Builder. On planned completion date, there may be things which remain to be completed due to weather, special items which you have requested, or items which have been back ordered.
>
> b. On completion date, all contract sums must be paid. Builder's remaining responsibilities shall be limited to the final work order and the Limited Warranty obligations.

Paragraph 17.0 provided that "[a]ny dispute between the Builder and the Client about this agreement and the adequacy of any performance under this agreement" could be submitted to arbitration. Paragraph 18.0 contained a warranty clause under which "Builder warrants that the Residential Maintenance & Alterations will be free from defects in material and work for one year from the date the building is substantially complete and ready for occupancy." The warranty clause states that repair or replacement is the exclusive remedy.

In December 2008, GHI and the LaHoods agreed to modify the contract. The modified agreement recites that the residential construction was substantially complete, that GHI had submitted a final invoice for $336,619.78, and that the parties had compromised a disagreement over the final invoice by the LaHoods promising to pay $225,000 under a promissory note that was to be secured by a mortgage against the property. The LaHoods and GHI also agreed to release various claims against each other.

GHI later filed this action against the LaHoods to collect the balance owed under the promissory note under an acceleration provision. GHI alleged that the LaHoods were in default because they failed to make a scheduled payment in June 2009. The LaHoods filed a counter-complaint against GHI, seeking money damages for negligence, breach of express and implied warranties, fraudulent misrepresentations, and violations of the Consumer Protection Act[2] and a third-party complaint against the Gardellas for fraudulent misrepresentations. A principal allegation underlying the LaHoods' claims was that construction defects caused moisture problems, which led to mold contamination and caused the LaHoods to suffer allergic reactions and respiratory problems.

[2] MCL 445.901 *et seq.*

After unsuccessful court-ordered facilitative mediation, GHI and the Gardellas filed a joint motion to sever the LaHoods' counterclaims and third-party claims from GHI's claim for breach of the promissory note. They proposed that the LaHoods' claim for personal injury be joined with a separate action that was filed on behalf of their minor children. In their response to the motion, the LaHoods requested an order compelling arbitration of all claims, counterclaims, and third-party claims.[3] After the trial court determined that the promissory note contained an arbitration clause, it denied the motion to sever and ordered that all claims, counterclaims, and third-party claims be submitted to arbitration. The court later denied GHI and the Gadrellas' motion for reconsideration.

II. PROMISSORY NOTE

GHI and the Gardellas treat the trial court's decision granting summary disposition as a claim barred by the arbitration agreement[4], and argue that the court's decision was procedurally improper because no formal motion for summary disposition was filed by the LaHoods. They also argue that the trial court's decision was substantively incorrect because, under the parties' modified agreement, only express warranty claims remained subject to arbitration.

We believe that GHI and the Gardellas' reliance on the cited summary disposition subrule[5] is misplaced as a separate court rule[6] established the procedures for the court to order arbitration. Regardless of which subrule the LaHoods should have filed a formal motion under[7], GHI and the Gardellas have not established that they were prejudiced by the absence of a formal motion. Thus, appellate relief is not warranted because of any procedural deficiency.[8]

We agree that the trial court erred in finding that the promissory note, which was the basis for GHI's principal complaint, contained an arbitration clause. "The existence of an arbitration agreement and the enforceability of its terms are judicial question for the court, not the arbitrator."[9] We review de novo a trial court's determination that an issue is subject to

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[3] MCR 3.602.

[4] MCR 2.116(C)(7).

[5] *Id.*

[6] MCR 3.602(B).

[7] MCR 2.116(C)(7) or MCR 3.602(B).

[8] MCR 2.613(A); *Al-Maliki v LaGrant,* 286 Mich App 483, 486; 781 NW2d 853 (2009); *Boulton v Fenton Twp,* 272 Mich App 456, 463-464; 726 NW2d 733 (2006).

[9] *City of Ferndale, v Florence Cement Co,* 269 Mich App 452, 458; 712 NW2d 522 (2006).

arbitration.[10] Issues involving contract interpretation also present question of law that are reviewed de novo.[11]

As this Court has explained:

> A three-part test applies for ascertaining the arbitrability of a particular issue: "1) is there an arbitration agreement in a contract between the parties; 2) is the disputed issue on its face or arguably within the contract's arbitration clause; and 3) is the dispute expressly exempted from arbitration by the terms of the contract." This Court has expressed a general disapproval of segregating disputed issues "into categories of 'arbitrable sheep and judicially-triable goats'." "Any doubts about the arbitrability of an issue should be resolved in favor of arbitration."[12]

There is no dispute that the residential construction contract between GHI and the LaHoods contains an arbitration clause. Thus, had there been no change in the payment terms, the arbitration clause would apply to any dispute concerning the LaHoods' obligation to make payments, inasmuch as the clause applies to "[a]ny dispute between the Builder and the Client about this agreement and the adequacy of any performance under this agreement." But parties to a statutory arbitration agreement may mutually consent to revoke the agreement[13] and the residential construction contract allowed the parties to modify the agreement by "written document signed by the parties."

It is clear that GHI and the LaHoods agreed to modify the residential construction contract through a separate written agreement. Mutual assent is an essential element of a contract modification.[14] Parties may waive certain terms of an original agreement through a later agreement.[15]

The parties' modification agreement contains waivers by both parties. The LaHoods agreed to release, acquit, and discharge "GHI, its directors, shareholders and employees, Ray Gardella and Sean Gardella, from any and all claims related to, arising from and/or in connection with the Contract and/or the Property, save and except warranty claims pursuant to the Contract[.]" The phrase "any and all claims" is indicative of a broad waiver of claims under the

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[10] *In re Nestorovski Estate*, 283 Mich App 177, 184; 769 NW2d 720 (2009); *Rooyakker & Sitz, PLLC v Plante & Moran, PLLC*, 276 Mich App 146, 152; 742 NW2d 409 (2007).

[11] *Sweebe v Sweebe*, 474 Mich 151, 154; 712 NW2d 708 (2006).

[12] *In re Nestorovski*, 283 Mich App at 202-203 (internal citations omitted).

[13] *Wold Architects & Engineers v Strat*, 474 Mich 223, 228-229; 713 NW2d 750 (2006); see also MCL 600.5001(2).

[14] *Quality Prod & Concepts v Nagel Precision, Inc*, 469 Mich 362, 372; 666 NW2d 251 (2003).

[15] *Adell Broadcasting Corp v Apex Media Sales, Inc*, 269 Mich App 6, 11; 708 NW2d 778 (2005).

residential constructional contract.[16] The modification agreement unambiguously excepts only "warranty claims pursuant to the Contract." "Contract" is defined in the modification agreement as the "residential construction contract." It follows that warranty claims are still subject to the arbitration clause of the residential construction contract.

GHI's release in the modification agreement is also broad. GHI agreed to release, acquit, and discharge "any and all claims for payment related to, arising from and/or in connection with the Contract and/or the Property other than as reflected in this Agreement." This waiver eliminates any payment obligation that the LaHoods might have under the residential construction contract. That obligation was replaced by a new, compromised payment obligation of $225,000, payable in ten installments, as set forth in the promissory note.

"Where one writing references another instrument for additional contract terms, the two writings should be read together. The Court must look for the party's intent within the contract where the words of a written contract are not ambiguous or uncertain."[17] A contract is ambiguous where "two provisions irreconcilably conflict . . . or when [a term] is equally susceptible to more than a single meaning."[18] "If no reasonable person could dispute the meaning of ordinary and plain contract language, the Court must accept and enforce contractual language as written, unless the contract is contrary to law or public policy."[19]

Although it is clear from the content of the promissory note that the parties contemplated that GHI could take action to collect the specified payment, the promissory note cannot reasonably be construed as contemplating arbitration. The parties agreed:

> Maker agrees that Maker's obligations under this Note are absolute and unconditional. Maker agrees that Maker's obligations under this Note shall not be subject to any defense, setoff or counterclaim that may at any time be available to or be asserted by Maker. Maker hereby waives, and agrees not to assert, any right to offset its obligations under this Note. Maker hereby agrees not to interpose as a defense or counterclaim any claim against the Holder in any action brought on this Note.

Construing the releases in the modification agreement with the promissory note, we conclude that the trial court erred in holding that the promissory note was subject to arbitration. Engrafting the arbitration clause onto the promissory note would contravene the parties'

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[16] See *Calladine v Hyster Co,* 155 Mich App 175, 182; 399 NW2d 404 (1986), abrogated in part on other grounds *Mull v Equitable Life Assurance Society of US*, 444 Mich 508; 510 NW2d 184 (1994).

[17] *Forge v Smith*, 458 Mich 198, 207; 580 NW2d 876 (1998) (footnotes omitted).

[18] *Coates v Bastian Bros, Inc,* 276 Mich App 498, 503; 741 NW2d 539 (2007) (internal quotation marks omitted).

[19] *Laffin v Laffin*, 280 Mich App 513, 517; 760 NW2d 738 (2008).

unambiguous intent to settle the matter with a payment obligation that is not subject to defenses or counterclaims. Because the promissory note does not contain an arbitration clause, we vacate the trial court's arbitration order.

The LaHoods argue on appeal that enforcement of the waiver-of-defenses clause in the promissory note contravenes public policy. There is no indication that the LaHoods presented this argument to the trial court in support of their claim that the promissory note was a proper subject of arbitration. Rather, they raised this issue only to oppose the motion to sever claims. To properly preserve an issue for appeal, it must be presented to and decided by the trial court.[20] "[T]his Court may overlook preservation requirements when failure to consider an issue would result in manifest injustice, if consideration of the issue is necessary to a proper determination of the case, or if the issue involves a question of law and the necessary facts for its resolution have been presented."[21]

A contract or contract provision may be unconscionable and contrary to public policy where a party has no meaningful choice and the terms unreasonably favor a party.[22] But unconscionability is a defense to a contract action.[23] Further, "[a] general rule of contract law is that a void section of an otherwise valid provision can be severed if it is not an essential part of the whole."[24] Because the LaHoods have not shown that their claim of unconscionability affects the parties' agreement to modify the residential construction contract in a manner that establishes new payment terms that are not subject to arbitration, it is unnecessary to reach this issue.

Finally, we reject GHI and the Gardellas's argument regarding whether the LaHoods, through their conduct, waived any right to arbitration. Waiver issues generally present mixed questions of fact and law.[25] While a party's participation in an action may be considered in determining if there is a waiver, it is also necessary to determine if the party arguing a waiver has established prejudice.[26] The trial court found only that the LaHoods' filing of a counter-complaint and third-party complaint did not negate the arbitration clause. Because nothing in the record indicates that GHI or the Gardellas pursued this waiver claim when replying to the LaHoods' request for arbitration, we find no basis for finding prejudice and no basis for disturbing the trial court's decision.

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[20] *Fast Air, Inc v Knight*, 235 Mich App 541, 549; 599 NW2d 489 (1999); see also *City of Riverview v Sibley Limestone*, 270 Mich App 627, 633 n 4; 716 NW2d 615 (2006).

[21] *Steward v Panek*, 251 Mich App 546, 554; 652 NW2d 232 (2002).

[22] *Allen v Mich Bell Tel Co*, 18 Mich App 632, 636-638; 171 NW2d 689 (1969); see also *Liparoto Constr, Inc v Gen Shale Brick, Inc*, 284 Mich App 25, 30; 772 NW2d 801 (2009).

[23] *Rory v Continental Ins Co*, 473 Mich 457, 470 n 23; 703 NW2d 23 (2005).

[24] *Peeples v Detroit*, 99 Mich App 285, 296; 297 NW2d 839 (1980).

[25] *Sweebe*, 474 Mich at 154.

[26] *Madison Dist Pub Sch v Myers*, 247 Mich App 583, 588-589; 637 NW2d 526 (2001).

Because the trial court erred in determining that the promissory note contains an arbitration clause, we vacate the arbitration order and remand for further proceedings. We express no opinion whether any of the LaHoods' counterclaims would be subject to arbitration as part of the warranty claims retained by the modification agreement.

III. NONPARTIES TO ARBITRATION AGREEMENT

GHI and the Gardellas also argue that the trial court erroneously ordered the Gardellas to participate in arbitration because they were not parties to the residential construction contract, the modification agreement, or the promissory note.

The sole claim against the Gardellas in the third-party compliant is for fraudulent misrepresentation. Even assuming that this claim is related to warranties in the residential construction contract, we agree that there is no basis for compelling the Gardellas to litigate the claim in arbitration. GHI and the LaHoods agreed to have disputes between the "Builder and the Client" submitted to arbitration. Because the residential construction contract defines "Builder" as GHI, the trial court erred in applying the arbitration clause to a dispute between the Gardellas and the LaHoods.

The trial court's decision also contravenes the well-settled rule that "[a]n agreement to arbitrate is a matter of contract."[27] "It goes without saying that a contract cannot bind a nonparty."[28] Arbitration cannot be imposed on a party that was not a legal or factual party to an agreement.[29] In other words, "a party cannot be required to arbitrate an issue that the party has not agreed to submit to arbitration."[30] In order to bind nonsignatories to an arbitration agreement, ordinary contract principles, such as incorporation by reference, assumption, agency, veil-piercing, and estoppel are considered.[31] The LaHoods have not presented any basis for binding the Gardellas to the arbitration agreement. Accordingly, we vacate the trial court's order compelling them to participate in arbitration.

III. MOTION TO SEVER

GHI and the Gardellas also challenge the trial court's decision denying their motion to sever the LaHoods' personal injury claims from GHI's action on the promissory note. A trial

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[27] *City of Ferndale*, 269 Mich App at 458.

[28] *EEOC v Waffle House, Inc*, 534 US 279, 294; 122 S Ct 754; 151 L Ed 2d 755 (2002).

[29] *St Clair Prosecutor v AFSMCE*, 425 Mich 204, 223; 388 NW2d 231 (1986); *Hetrick v Friedman*, 237 Mich App 264, 267; 602 NW2d 603 (1999), disapproved on other grounds *Wold Architects & Engineers*, 474 Mich 223, 232 n 3 (2006).

[30] *Hetrick*, 237 Mich App at 267.

[31] *Thomson-CSF, SA v American Arbitration Ass'n*, 64 F3d 773, 776 (CA 2, 1995).

court has discretion to sever claims.[32] "[A]n abuse of discretion occurs only when the trial court's decision is outside the range of reasonable and principled outcomes."[33]

The trial court's decision to deny the motion for severance was based solely on its erroneous determination that all claims, counterclaims, and third-party claims should be submitted to arbitration. Because the court lacked a reasoned and principled basis for its ruling, its decision constitutes an abuse of discretion. We note that GHI and the Gardellas' joint motion to sever, as presented to the trial court, relied on MCR 2.206, which addresses permissive joinder of parties, and MCR 2.207, which addresses the consequences of misjoinder or nonjoinder or parties, to argue that GHI would be prejudiced if its contract claim was linked to the LaHoods' counterclaim for negligence and third-party complaint. GHI and the Gardellas proposed that the latter claims be joined in the separate action brought on behalf of the LaHoods' minor children. GHI and the Gardellas now argue on appeal that claims based on the alleged medical condition of the LaHoods were released and that severance is warranted.[34] See *LeGendre v Monroe Co*, 234 Mich App 708, 720-721; 600 NW2d 78 (1999).

Because the trial court's denial of the motion to sever was based on its erroneous determination that all claims, counterclaims, and third-party claims were subject to arbitration, and given the circumstances of this case, including the apparent modification of the grounds relied on by GHI and the Gardellas for their motion, we conclude that it is appropriate to vacate the trial court's order denying the motion for severance and to remand this case for further proceedings.

Vacated and remanded for further proceedings not inconsistent with this opinion. We do not retain jurisdiction.

/s/ William B. Murphy
/s/ Michael J. Talbot
/s/ Christopher M. Murray

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[32] *Jemaa v MacGregor Athletic Prod*, 151 Mich App 273, 278; 390 NW2d 180 (1986).

[33] *Saffian v Simmons*, 477 Mich 8, 12; 727 NW2d 132 (2007).

[34] MCR 2.505(B).