IN THE SUPREME COURT OF THE STATE OF DELAWARE

CHRISTOPHER OLSEN and ELIZABETH B. DEAN,	§	
	§	No. 523, 2005
Defendants Below, Appellants/Cross-Appellees,	§	Court Below: Superior Court of the State of Delaware in and for Sussex County
v.	§	
T.A. TYRE GENERAL CONTRACTOR, INC.,	§	C. A. No. 04L-03-001
Plaintiff Below, Appellee/ Cross Appellant.	§	

Submitted: June 21, 2006
Decided: August 24, 2006

Before **STEELE,** Chief Justice, **BERGER** and **JACOBS**, Justices.

O R D E R

This 24th day of August 2006, upon consideration of the briefs of the parties and the record in this case, it appears to the Court that:

1. Christopher Olsen and Elizabeth Dean (the "owners"), who are the defendants-below appellants, contracted with the plaintiff-below appellee, T.A. Tyre General Contractor, Inc. (the "contractor"), to build a home on the owners' property located at 413 Burton Avenue in Lewes, Delaware. That contract is the subject of this litigation. The owners claim that Superior Court erred by: (i) considering *sua sponte* an affirmative defense that the contractor had not asserted

at trial, thereby depriving the owners of notice and a meaningful opportunity to be heard; (ii) ruling that the liquidated damages clause of the contract was an unenforceable penalty; and (iii) awarding certain fees under the doctrine of *quantum meruit*. On its cross-appeal, the contractor claims that Superior Court erred by not awarding it $27,765.04 in additional fees on a *quantum meruit* basis. For the reasons next discussed, we reverse the order dismissing the liquidated damages claim, and reverse in part and affirm in part the award of fees under the *quantum meruit* doctrine.

2. On November 10, 2002, the parties executed a contract to build a home. The contract called for construction to start 6 to 8 weeks after the signing, and to be completed within 7 months of starting. A liquidated damages clause provided that $200 a day could be deducted from the contract price if the project was not substantially complete within 90 days of the projected completion date. The contract further provided that all change orders were to be in writing and signed by both parties, and that any disputes were to be addressed first by the architect, John Mateyko, as the arbiter of first resort.

3. Construction began in February 2003, and a certificate of substantial completion was issued on February 13, 2004. Before that certificate issued, the contractor demanded payment from the owners of an additional $30,000 for change orders, all of which were dated February 3, 2004 and unsigned. The

architect reviewed those change orders and recommended that the owners pay only $2,544.19, but left it to the owners to decide whether or not to pay.

4. The owners then asserted a claim against the contractor for liquidated damages totaling $43,000, because the home was completed 215 days late. The architect reviewed that claim and determined that the contractor was responsible for 194 days of liquidated damages, totaling $38,800. The contractor then filed a Superior Court action to impose a mechanic's lien on the home in the amount of $23,909.28. The owners counterclaimed in that action for breach of contract, seeking to recover the architect's $38,800 suggested liquidated damages award.

5. The Superior Court held a three-day trial on these claims. The trial court rejected the liquidated damages claim, having ruled *sua sponte* that the liquidated damages clause was unenforceable as a penalty. The trial court also rejected the contractor's $27,765.04 *quantum meruit* claim, except for $2,544.19 of unsigned change orders approved by the architect. Both parties appeal from those rulings.

6. The owners claim that the trial court erred by determining *sua sponte* that the liquidated damages clause of the contract was unenforceable as a penalty. That ruling was procedurally unfair, the owners argue, because the trial court required them, without any prior notice, to prove the clause's validity, thereby depriving them of a meaningful opportunity to do so. The owners also claim that

the trial court's conclusion that the liquidated damages provision was unenforceable is legally erroneous as a substantive matter. We first address those claims.

7. The trial court concluded that the liquidated damages provision was a penalty because: (1) the damages would be $73,000 per year on a home that cost only slightly over $300,000 to build; (2) the liquidated damages provision contained the term "penalty," which suggested that it was punitive; and (3) to the extent the provision stripped away the 90-day grace period if the contractor was one day late after the 90 day period, it was punitive. The trial court further found that the owners had otherwise failed to show that the provision was valid.

8. From a review of the record, it appears that the validity of the liquidated damages clause was never fully litigated. Nor did the trial court apply the two-pronged test for analyzing the clause's validity mandated by *Brazen v. Bell Atlantic Corporation*.[1] Failure to afford the parties an opportunity to argue that legal issue was unjust, particularly because the trial court concluded that the owners had not met their burden of proving the clause's validity. Therefore, the

[1] 695 A.2d 43, 48-49 (Del. 1997) (holding that the two-pronged test for analyzing a liquidated damages clause's validity considers: (1) the certainty of the actual damages and (2) the reasonableness of the liquidated damages amount agreed upon). "Where the damages are uncertain and the amount agreed upon is reasonable, such an agreement will not be disturbed." *Id.* We also note that the trial court placed undue reliance on the use of the term "penalty" in the clause's text. Use of the word "penalty" or "liquidated damages" in a contract is not conclusive as to the character of the disputed provision. *In the Matter of the Receivership of D. Ross & Son, Inc.*, 95 A. 311, 315 (Del. Ch. 1915).

order dismissing this claim must be reversed, and the claim remanded to the Superior Court to allow the parties an opportunity to litigate whether the disputed provision is a liquidated damages provision or a penalty under *Brazen* and its progeny.

9. The owners' final claim is that the Superior Court erred by awarding $2,544.19 to the contractor on a *quantum meruit* basis. On its cross-appeal the contractor argues that the trial court was correct in awarding the $2,544.19, but erred in declining to award payment for the remaining 43 unsigned change orders under the same *quantum meruit* theory. We review these claims for abuse of discretion.[2]

10. The trial court considered the 43 unsigned change orders, and held that the change orders did not qualify for payment under the contract, because the contract language specifically required that all change orders must be signed by all of the parties. The trial court did find, however, that in his memorandum dated February 19, 2004, the architect reviewed the same 43 change orders and concluded that the contractor should be compensated only $2,544.19. The trial court credited the architect's analysis of those particular change orders and awarded the $2,544.19 amount to the contractor.

[2] *See Chavkin v. Cope*, 243 A.2d 694, 695 (Del. 1968).

11. On their cross appeal, the owners claim that the $2,544.19 amount was not recoverable either under the contract or under the doctrine of *quantum meruit*, and that the architect's recommendation cannot alone render those invalid change orders compensable. The contractor responds that the award was made on the basis of *quantum meruit*, and not on the contract, and therefore should be upheld.

12. The architect's memorandum, upon which the trial court relied, does not disclose the basis for awarding the $2,544.19 of change order payments. The architect classified the $2,544.19 of compensable change orders as "extra work, determined by the Architect to have, with sufficient clarity, substantive merit as additional work." The architect then proceeded to explain, with varying degrees of specificity, why he would approve each of the particular component items. Most of the explanations, however, stated no more than "approved." The architect's memorandum included a statement made by the contractor (at the time it delivered the additional change orders in question) that "I was not going to charge you for any of these items as extras and just consider that part of the work but when you did not pay me my draw last week I decided to go for it and treat them as 'Change Orders.'"

13. Without further explanation by the trial court as to why it found the architect's analysis persuasive and why as a matter of law $2,544.19 of those items

were recoverable, we cannot uphold the award, even the $2,544.19. The trial court ruled that none of the 43 change orders was recoverable under the contract language because they were all unsigned. Nor can the doctrine of *quantum meruit* provide a vehicle for recovery. To recover in *quantum meruit*, the performing party under a contract must establish that it performed services with an expectation that the receiving party would pay for them, and that the services were performed under circumstances that should have put the recipient on notice that the performing party expected the recipient to pay for those services.[3] Here, however, the architect's memorandum specifically quotes the contractor's statement that it did not intend to bill the owners for those items, which negates the *quantum meruit* requirement that the performing party expected payment. Because the trial court provided no explanation for why it relied on the architect's analysis, the $2,544.19 award was arbitrary and cannot stand.

14. Finally, we reject the contractor's claim that the trial court should have awarded it payment for all 43 unsigned change orders. Although the trial court did not explain why it rejected the contractor's *quantum meruit* claim for those change orders, there was sufficient evidence to support the court's conclusion that "no basis [existed] to support the contractor's other claims."

[3] *Constr. Sys. Group, Inc. v. The Council of Sea Colony, Phase I*, 1995 Del. LEXIS 379 (Del. Supr.).

15. First, the contractor's own statement establishes that it did not intend to bill the owners for the 43 items until the parties' relationship became adversarial. Moreover, during the meetings between the owners, architect and contractor where new plans and revisions were discussed, the contractor never disclosed to the owners that those 43 revisions (for which the contractor later created the unsigned change orders) could result in additional costs. Based on this evidence, the trial court could have reasonably found that the owners were never given notice that they would be expected to pay for those unsigned change orders. Because there was sufficient evidence to negate each prong of the *quantum meruit* analysis, we uphold the Superior Court's denial of the contractor's *quantum meruit* claim for the 43 unsigned change orders.[4]

NOW, THEREFORE, IT IS ORDERED that the judgments of the Superior Court are **REVERSED IN PART, AFFIRMED IN PART,** and **REMANDED IN PART** for proceedings consistent with this Order.

BY THE COURT:

/s/ Jack B. Jacobs
Justice

[4] We decline to address the owners' statute of limitations argument on this claim, because the owners failed to raise it in their opening brief. *Murphy v. State*, 632 A.2d 1150, 1152 (Del. 1993).