

Affirmed and Memorandum Opinion filed May 25, 2017.



In The

Fourteenth Court of Appeals

NO. 14-16-00388-CV

EXCELA ENERGY, LLC, Appellant

V.

EXALT REAL ESTATE GROUP, LLC, Appellee

**On Appeal from the 11th District Court
Harris County, Texas
Trial Court Cause No. 2015-57965**

M E M O R A N D U M O P I N I O N

This appeal involves an alleged unenforceable penalty. Appellee Exalt Real Estate Group, LLC sued appellant Excela Energy, LLC for, as relevant here, breach of contract. Excela asserted a counterclaim for breach of the same contract—a commercial lease—on which Exalt sued. The trial court granted Exalt’s motion for summary judgment for affirmative relief on its breach of contract claim, granted summary judgment in Exalt’s favor on Excela’s

counterclaim, and awarded Exalt damages. Excela appeals the summary judgment as to damages only, not liability. Concluding Excela's unenforceable penalty defense is not preserved, we affirm.

Background

Exalt is the landlord of a commercial building, in which Excela was a tenant. The parties entered into a written lease for office space, for a four-year term. Excela defaulted on the lease by failing to pay rent. Exalt terminated Excela's right of possession of the leased premises and filed this lawsuit for breach of contract, seeking all rents and damages under the lease. Exalt also named Excela's co-tenant, Oiltech Solutions, LLC, as a defendant.¹ In addition to its claim for damages, Exalt asserted a claim to foreclose on its contractual landlord's lien on the personal property remaining in the leased premises. Excela answered, generally denying Exalt's allegations and pleading the affirmative defense of unclean hands.

Exalt moved for summary judgment, arguing that the unambiguous language of the lease conclusively established Excela's breach. According to Exalt, the lease provides that failure to pay rent when due constitutes an "event of default." Excela's failure to pay rent therefore constituted a breach, and Exalt offered evidence of its damages, including past-due rent. Exalt also sought future rent that would have accrued through the remainder of the lease term, under the lease's "Remedies" clause, which provided:

Upon any Event of Default, Landlord may . . . [t]erminate this Lease by written notice to Tenant. . . . If this Lease is terminated hereunder, Tenant shall pay to Landlord: (1) all Rent accrued through the date of termination, (2) all amounts due under Section 22, and (3) an amount

¹ Oiltech is not a party to this appeal.

equal to: (A) the total Rent that Tenant would have been required to pay for the remainder of the Term discounted to present value

Excelsa did not file a response to Exalt's motion, but instead moved to adopt its co-defendant Oiltech's response.² Oiltech argued that Exalt's motion should be denied because: (1) Exalt based its arguments on an incorrect interpretation of the lease; (2) Exalt miscalculated the rent owed, if any, as damages, including the future rent Exalt claimed it was owed for the remainder of the lease term; and (3) Exalt's prior breach excused Oiltech's nonperformance.

The trial court granted Exalt's motion for summary judgment and ordered that Exalt recover from Excelsa and Oiltech, jointly and severally, \$178,509.94, plus prejudgment interest, postjudgment interest, attorney's fees, and court costs. The trial court also ordered that Exalt have foreclosure of its contractual landlord's lien on the personal property of Oiltech and/or Excelsa remaining in the leased premises. The final judgment specified that Excelsa was to take nothing on its claims against Exalt.

Excelsa appeals from the trial court's judgment as to damages only; Excelsa does not challenge the judgment on liability, on Exalt's lien, or on Excelsa's counterclaim.³

Analysis

On appeal, Excelsa argues, in two interrelated issues, that the contractual provision Exalt relied on when seeking the future rent owed for the remainder of the lease term is an unenforceable penalty as a matter of law, and thus the trial court erred in granting summary judgment on damages. Exalt responds that the

² There is no order in the record granting Excelsa's motion to adopt Oiltech's response.

³ Oiltech initially appealed from the trial court's judgment as well, but then moved to withdraw its notice of appeal. By order dated July 6, 2016, this court dismissed Oiltech from the appeal.

issue is waived, because Excelsa never asserted an affirmative defense of illegality or argued the issue to the trial court in response to Exalt's motion for summary judgment. We agree with Exalt.

Regardless whether the contractual-damages clause here is a penalty as a matter of law, an assertion that a contractual provision creates an unenforceable penalty is an affirmative defense that a party must raise in responsive pleadings. *See Grace Interest, LLC v. Wallis State Bank*, 431 S.W.3d 110, 128 (Tex. App.—Houston [14th Dist.] 2013, pet. denied) (citing Tex. R. Civ. P. 94); *see also Tesch v. Equity Secured Capital, L.P.*, No. 03-13-00539-CV, 2015 WL 8587311, at *3 & n.5 (Tex. App.—Austin Dec. 11, 2015, pet. denied) (mem. op.); *Dunlap v. Gayle*, No. 13-12-00105-CV, 2013 WL 1500377, at *5-6 (Tex. App.—Corpus Christi Apr. 11, 2013, no pet.) (mem. op.). Excelsa admits that it did not plead penalty in the trial court.

Excelsa nevertheless argues that its failure to plead the defense is inconsequential because the issue “was readily apparent from the pleadings.” While Excelsa cites *Phillips v. Phillips*, 820 S.W.2d 785 (Tex. 1991), to support its argument, we find *Phillips* distinguishable. In *Phillips*, the Texas Supreme Court held that the defense of penalty is not waived by the failure to plead it, if it is apparent on the face of the petition and established as a matter of law. *See id.* at 790. There, a limited partner sued a general partner for dissolution of the limited partnership. *Id.* at 787. After a jury awarded the limited partner actual damages, the limited partner argued that she was entitled to recover liquidated damages equal to ten times the actual damages found by the jury, as provided by the limited partnership agreement. *Id.* at 787-88. The trial court refused to award the decuple damages, and the limited partner appealed. *Id.* On appeal, in response to the general partner's contention that the contractual provision was an unenforceable

penalty, the limited partner argued that the general partner had waived any penalty defense by failing to plead it. *Id.* at 788. The court rejected that argument, holding that the defense of penalty was not waived by the lack of pleading because it was apparent on the face of the petition and established as a matter of law. *Id.* at 790.

To be sure, courts will not enforce a plainly illegal contract even if the parties do not object because enforcement of an illegal agreement violates public policy. *Id.* at 789; *see also RR Maloan Invs., Inc. v. New HGE, Inc.*, 428 S.W.3d 355, 362 (Tex. App.—Houston [14th Dist.] 2014, no pet.); *Cruse v. O’Quinn*, 273 S.W.3d 766, 776 (Tex. App.—Houston [14th Dist.] 2008, pet. denied). The *Phillips* court refused to enforce an illegal contract penalty because the provision was unenforceable on its face—as established by the plaintiff’s pleading—even though the defending party did not plead illegal penalty in its answer. Although a lack of affirmative pleading in an answer is not necessarily fatal to an illegal penalty defense, the party asserting a penalty defense must still raise it in the trial court. *Phillips* makes clear that asserting illegal penalty for the first time on appeal is too late, even when the contract provision is an unenforceable penalty on its face. *See* 820 S.W.2d at 790 (“We do not hold that penalty can be asserted as a defense for the first time on appeal.”) (internal quotation omitted). Because the record in *Phillips* reflected that the issue of penalty was raised in the trial court, the issue was not waived and the Supreme Court of Texas addressed it. *See id.*

Here, in contrast to *Phillips*, Excelsa did not plead unenforceable penalty in its answer, assert it in a summary judgment response, or otherwise raise it in the trial court before the judgment became final. Also in contrast to *Phillips*, in which the plaintiff’s pleading clearly established that the damages multiplier was an unenforceable penalty, Exalt simply pleaded for “all damages from [Excelsa] permitted under the Lease and applicable Texas law, including, but not limited to,

all Rent accrued and accruing under the terms of the Lease.” *Cf. id.* (“Inasmuch as [the plaintiff’s] own pleading establishes that the contractual provision she relies upon is an unenforceable penalty . . . as a matter of law, [the defendant] was not required to plead penalty as an affirmative defense.”). Any alleged penalty is not “apparent on the face of [Exalt’s] petition,” and thus *Phillips* does not control. *Id.* at 789.

We conclude that Excela waived its penalty defense and may not raise it for the first time on appeal. *See id.* at 790; *Grace Interest*, 431 S.W.3d at 128 (finding waiver when party failed to raise unenforceable penalty issue in responsive pleading or summary judgment response) (citing *Hassell Constr. Co., Inc. v. Stature Commercial Co., Inc.*, 162 S.W.3d 664, 667 (Tex. App.—Houston [14th Dist.] 2005, no pet.)); *Dunlap*, 2013 WL 1500377, at *6.⁴

We overrule Excela’s two issues.

Conclusion

We affirm the trial court’s summary judgment.

/s/ Kevin Jewell
Justice

Panel consists of Justices Christopher, Busby, and Jewell.

⁴ Excela cites *Santiago v. Mackie, Wolf, Zientz & Mann, P.C.*, No. 05-13-00620-CV, 2014 WL 4072131 (Tex. App.—Dallas Aug. 19, 2014, pet. denied) (mem. op.), to support its argument that it did not waive its defense by failing to bring it to the attention of the trial court. *Santiago* is plainly distinguishable; there, the defendant moved for summary judgment on an unpleaded affirmative defense, and the trial court granted the motion, thereby adjudicating the issue. *See id.* at *3. The defendant did not raise the defense for the first time on appeal. Rather, the issue on appeal was whether the trial court erred in granting summary judgment on an unpleaded affirmative defense after the plaintiffs expressly objected. *See id.* *Santiago*, therefore, is inapplicable to our analysis.