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AVOID CONTRACTING YOUR CONSTRUCTION LIEN SHIELD AWAY: POTENTIAL RISK COMMERCIAL LANDLORDS FACE WHEN FACILITATING AND FUNDING A TENANT'S BUILD-OUT

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Last month, the Third District Court of Appeal in Florida filed its opinion in *K.D. Constr. of Fla., Inc. v. MDM Retail, Ltd.*, 2021 WL 5617447 (Fla. 3d DCA Dec. 1, 2021), addressing a significant concern facing many commercial landlords—when can construction liens for tenant improvements attach to the landlord's ownership interest in the leased property? The Court's opinion gives insight on the statute governing this concern (Section 713.10, Florida Statutes) and provides an exemplar of what commercial landlords should not do.

Overview of Section 713.10 – "Extent of Liens" and the "Pith of the Lease"

Section 713.10 of Florida's Construction Lien Law, and its predecessors, have spawned substantial litigation for decades concerning whether construction liens for tenant improvements can attach to a commercial landlord's interest in the leased property. Well-established Florida law holds that a commercial landlord's interest is subject to construction liens arising from improvements made on its property when: (1) an agreement between the landlord and tenant requires the tenant to make certain improvements; ***or*** (2) the lease terms make it obvious that the improvements were the "pith of the lease." Tenant improvements are considered the "pith of the lease" when they are "essential to the purpose of the lease" and "vital to its perpetuality." Simply stated, tenant improvements are the pith of the lease when the parties would not have signed the lease but for the contemplated tenant improvements. However, the mere fact that a tenant ***may*** make improvements to the property per the terms of the lease is insufficient—even when a landlord consents to the improvements. The purpose of Section 713.10 stems from Florida's strong public policy that contractors, laborers, and materialmen always receive full and complete protection of payment for labor and materials furnished to improve property. It was intended to "cut off every defense" a landlord may raise to avoid payment for improvements that benefit the landlord's property.

Understandably, commercial landlords often try to protect themselves by including lien liability disclaimers in leases that prohibit the landlord's property interest from being subject to liens for improvements made

by or on behalf of the tenant. Additionally, the Florida Legislature created mechanisms in Section 713.10 that allow commercial landlords to insulate themselves from construction lien liability in tenant build-out situations. The statute explicitly states: "The interest of the lessor is not subject to liens for improvements *made by the lessee* when: (1) the lease, or a short form or memorandum of the lease that contains the specific lease language prohibiting such liability, is recorded in official records of the county where the premises is located before a notice of commencement for the improvements is recorded and the terms of the lease expressly prohibit such liability; ***or*** (2) the lease terms expressly prohibit such liability, and a notice advising that leases for the rental of the premises prohibit such lien liability is recorded in the official records of the county where the premises is located before a notice of commencement for the improvements is recorded. The notice must include: (a) the name of the tenant; (b) the legal description of the property the notice applies to; (c) the specific lease language prohibiting such lien liability; and (d) a statement that all or most of the leases for the premises on the property expressly prohibit such lien liability."

Consequently, Section 713.10 provides landlords with the means to shield their properties from construction liens arising from work performed by their tenants. However, strict compliance with the procedure and language of the statute is required for landlords to maintain this shield, As shown in *K.D. Constr. of Fla., Inc. v. MDM Retail, Ltd.*, failure to operate within the plain language of the statute can result no lien protection at all.

Facts of the Case

The Landlord, MDM Retail, Ltd., owned commercial property and entered a lease with the Tenant, Metsquare Cinema, LLC, to develop and operate a movie theater within a premises on the property. Like many commercial leasing arrangements, the Landlord agreed to facilitate and partially fund the Tenant's build-out of the premises for its intended use. Likewise, the lease agreement contained a provision common to many commercial leases providing that the "interest of Landlord in the Premises shall not be subject in any way to any liens . . . for improvements to . . . the Premises by or on behalf of Tenant." This provision was made with express reference to Section 713.10. A memorandum of lease quoting this prohibiting provision was later recorded in the official records of the county.

The Landlord and Tenant then entered into a construction agreement with a general contractor to make improvements to the leased premises. Notably, the agreement listed both the Landlord and Tenant as "Owners," and included the percentage of each party's allocated payment obligation characterized as "separate scopes of work." Generally, the Landlord was financially responsible for two-thirds of the build-out. Thereafter, the Landlord filed several Notices of Commencement. Several years later, the Subcontractor, K.D. Construction, was hired by the contractor to perform stud and drywall work for the movie theater. After fulfilling its subcontract obligations, the Subcontractor recorded a claim of lien against the Landlord's property asserting a portion of the amounts owed to the Subcontractor remained unpaid.

Accordingly, the Subcontractor sued the general contractor and the Landlord to foreclose its lien—but not the Tenant. The Landlord moved for summary judgment arguing that it protected itself from the Subcontractor's claim by including language in the lease that expressly prohibited lien liability for improvements made "by or on behalf of Tenant," and recording the memorandum of lease with this language before issuing a notice of commencement for the theater build-out. The Landlord acknowledged that it was a party to the construction agreement, but argued it was merely a co-signor to facilitate and fund the contracted improvements on the Tenant's behalf. The Landlord argued, "it makes no difference whether the lessor benefits from the improvements, contemplates the improvements, or co-signs for the improvements, so long as the lessor records the required disclaimer of liability." This persuaded the trial

court to grant summary judgment in the Landlord's favor on the basis that Section 713.10 prevented the Subcontractor's lien from being enforced against the Landlord's property.

The Parties' Arguments on Appeal and the Court's Opinion

On appeal, the Subcontractor claimed that the trial court misinterpreted the construction agreement and misapplied Section 713.10. It argued the Landlord was party to the construction agreement as an "Owner"—not a co-signer. And, as such, was a party itself making improvements to the premises becoming directly responsible for its allocated payment obligation under the construction agreement. The Subcontractor emphasized the language of Section 713.10, providing that a lien "shall extend to, and only to, the . . . interest of the person who contracts for the improvement . . .," and that landlords can only protect themselves from "liens for improvements made by the lessee . . ." Whether the improvements were made by the Landlord on the Tenant's behalf does not matter because the Landlord contracted for the improvements in its own capacity. To paraphrase the Subcontractor, Section 713.10 protects landlords from potential vicarious exposure to liens when improvements are made by the tenant, but it does not protect landlords from themselves when they contract for improvements regardless of lien liability disclaimers in a lease; to conclude otherwise would expand the landlord protections provided by Section 713.10 beyond their legislative intent.

In response, the Landlord maintained that it and the Tenant jointly engaged the general contractor to perform the movie theater build-out "as is [common] in commercial leasing arrangements of this sort" to facilitate and partially fund the tenant improvements. The Landlord downplayed the construction agreement's "separate scopes of work" and payment obligations by arguing they were merely percentage allocations of build-out costs for the Tenant's project—not improvements contracted for by the Landlord. The Landlord further argued that these "allocations" are ultimately inconsequential because all the improvements were made on behalf of the Tenant. In sum, the Landlord's position rested on its lease provision disclaiming lien liability for tenant improvements and its purported compliance with Section 713.10(2)(b).

The Third District Court, in a brief but decisive opinion, agreed with the Subcontractor and reversed summary judgment. The Court relied on the "plain and unambiguous language" of the statute to hold that the lien liability exceptions provided by Section 713.10 did not apply to the circumstances of this case. The Court's opinion emphasizes and relies on prior decisions supporting the position that: (1) a contractor cannot lien property where the landlord was not party to the construction contract; (2) a landlord's disclaimer pursuant to Section 713.10 protects it from liens arising out of the tenant's failure to satisfy its financial obligations; and (3) a lien against a landlord is invalid when it does nothing to hold itself out as assuming responsibility to pay for the work. Finally, the Court rested its opinion on public policy, holding that Section 713.10 should be liberally construed to protect laborers and materialmen from nonpayment.

What Does This Mean for Commercial Landlords?

This case serves as a signal to commercial landlords showing that boilerplate lien liability disclaimers prevalent in commercial leasing and compliance with Section 713.10 of Florida's Construction Lien Law are not always enough to ensure protection against construction liens for tenant improvements. The landlord's involvement in the build-out of a leased premises, legal obligations to contractors, and representations to parties involved are all considered when "liberally construing" Section 713.10. Despite being common practice for commercial landlords to "partially fund" or "facilitate" tenant improvements, contracts for tenant buildouts must be entered into cautiously and special attention is required to ensure compliance with the tedious components of Florida's Construction Lien Law. Otherwise, a landlord may inadvertently give up its shield against lien liability.

A note to the reader: This article is intended to provide general information and is not intended to be a substitute for competent legal advice. Competent legal counsel should be consulted if you have questions regarding compliance with the law.

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