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COMMERCIAL LEASE NEWSLETTERS

"PITH of the Lease" and What it Means to Commercial Landlords and Property Managers

In today's troubled economic times, there is a rash of lawsuits being initiated by contractors against tenants for leasehold improvements and tenant build outs. If the landlord fails to properly protect its interest as to the premises, the landlord's real property interest may be subject to a construction lien claim under Florida Statute §713 et. seq. by the contractor who was not paid by the tenant.

A phrase that most commercial landlords and property managers are not familiar with but may unfortunately become part of their vocabulary in lease disputes is: "PITH of the lease". This will be the phrase that the commercial landlords and commercial property managers will be faced with and may scratch their heads wondering what this exactly means. Pith is defined in the dictionary as:

pith\▪pith\ n 2. The essential part: CORE.

The phrase "PITH of the lease" is a phrase that arose in that certain case Edward L. Nezelek, Inc. v. Food Fair Properties Agency, Inc. 309 So. 2d. 219 (3rd DCA 1975) as cited in A. N. Drew, Inc. v. Frenchy's World Famous Cajun Café, Inc., et al., 517 So. 2d 766, 1988 Fla. App. In the A. N. Drew, Inc. case the tenant engaged a contractor to do tenant improvements at the subject premises. The tenant then performed those obligations as part of the initial lease transaction but failed to pay the contractor which contractor in turn sues to foreclose against the Lessor's interest in the real property so improved. Generally, when a tenant takes occupancy of the premises there is specific provision in the lease indicating what aspect of the build out is allocated for the landlord and which aspect of the build out is allocated to the tenant.

If the tenant contracts for certain work to be performed by the general contractor, the general contractor may provide a Notice to Owner to the landlord claiming that the contractor is looking to the real property for the work contracted for by the tenant. If the

tenant is authorized to perform such work, which generally arises under the lease agreement (and in fact may often be a leasehold obligation by the tenant per the lease, the "Pith of the Lease") then the contractor argues that this contractual obligation creates an authorized agency relationship between the tenant and the landlord to contract for such services and subjects the landlord's interest to a construction lien in the event that the contractor is not paid.

This has been further confirmed by Florida Statute §713.10:

> **"When an improvement is made by a lessee in accordance with an agreement between such lessee and her or his lessor, the lien shall extend also to the interest of such lessor."**

As indicated, given these turbulent economic times, there are numerous defaults occurring, tenants failing to maintain operations and evictions. However at the same time, such tenants are leaving behind a number of unpaid bills inclusive of bills for improvements made to the subject premises. The A. N. Drew case indicates that in the event that the leasehold improvements are being contracted for by the tenant and are the "Pith of the lease" (roughly interpreted as being a central component of the lease) then in such event the landlord's real property interest may be subject to the tenant's claim. This issue, which has always faced landlords, is even more compelling in today's marketplace. The question that needs to be answered is:

> **"What can a landlord or real property manger do to prevent the landlord's real property from being subjected to a construction lien in the event of a tenant's default and non payment of its contractor?"**

When a tenant is doing build-out of the lease premises, there may be a problem as to the payment to the contractor, subcontractor or material supplier. The problem arises when a contractor, laborer or material supplier attempts to assert a construction lien against the landlord's interest in the premises as a result of work being performed by the tenant in accordance with the contract. The landlord should be advised to comply with Florida Statute §713.10, which requires the memorandum of the lease agreement to be recorded in the public records indicating a restriction on liens being implemented as against the interest of the landlord to the subject premises. Florida Statute §713.10 states in pertinent part as follows:

> **"713.10 Extent of liens-Except as provided in s. 713.12, a lien under this part shall extend to, and only to, the right, title, and interest of the person who contracts for the improvement as such right, title, and interest exists at the commencement of the improvement or is thereafter acquired in the real property…When the lease expressly provides that the interest of the lessor shall not be subject to liens for improvements made by the lessee, the lessee shall notify the contractor making any such improvements of such provision or provisions in the lease, and the knowing or willful failure of the lessee to provide such notice to the contractor shall render the contract between the**

lessee and the contractor voidable at the option of the contractor. The interest of the lessor shall not be subject to liens for improvements made by the lessee when:

(1) The lease or a short form thereof is recorded in the clerk's office and the terms of the lease expressly prohibit such liability; or

2) All of the leases entered into by a lessor for the rental of premises on a parcel of land prohibit such liability and a notice which sets forth the following is recorded by the lessor in the public records of the county in which the parcel of land is located."

In either event, however, the Landlord needs to protect itself in these particular situations by compliance with Florida Statute §713.10. The case of A. N. Drew, Inc. v. Frenchy's World Famous Cajun Café, Inc., et al., 517 So. 2d 766, 1988 Fla. App. and Heinberg v. Henrickson 877 So. 2d 34 (DCA 2004) are worthy of review as to a contractor's claim of lien for Tenant improvements when the improvements constituted the "PITH" of the Lease. Care should be given in this area to seek the advice of an attorney in the preparation of a commercial lease.

We previously touched on this point in a prior newsletter, but to reiterate the position, the landlords and commercial property managers should be put on notice to review their leases and make sure that their leases and documents are in compliance with Florida Statute §713.10 to protect their real property interest. The commercial landlord needs to position itself to avoid having to pay for work performed by the tenant. This is even more troubling because generally when a tenant fails to pay its contractor for leasehold improvements, it is also generally not paying the landlord.

Next month, an additional area of concern for landlords and property managers in today's troubled economic times.