

LEASEHOLD CONSTRUCTION GOES BAD



COUNSEL'S CORNER

Body Bar, LLC, desired to open an upscale Pilates studio and juice bar in Plano, Texas. So Body Bar signed a lease for commercial property owned by Regency Centers. It was Body Bar's responsibility to construct the studio and bar. Regency was obligated to pay \$25,000 of the cost after successful completion.

Body Bar engaged Denco CS Corp as its general contractor.

Denco's completion was delayed due to the City of Plano's determination that portions of the construction plans failed to meet Plano's health code ordinances. To complete on time, Denco's employees, contractors and subcontractors worked overtime and on weekends. Those efforts increased the cost of the project by ~ \$29,000.

Denco sent Body Bar a bill for the excess. Body Bar refused to pay. Denco recorded mechanic's liens in Collin County. Body Bar sued Denco for breach of contract, improper "cloud on title" by recordation of wrongful Mechanic's Lien Affidavits, and other theories.

Denco responded by filing counterclaims of its own against Body Bar, seeking to recover its added \$29k in cost overruns through a legal theory of unjust enrichment, and asking the District Court to allow Denco to foreclose its liens.

The Collin County District Court ruled for Body Bar and entered Judgment accordingly. Denco appealed.

Part of the appeal was based on Denco's request to foreclose its liens. And that, dear reader, is the purpose of this article. Denco claimed it had two valid liens: one based on the Texas Constitution, the other based on Texas statutes.

The Appellate Court analyzed the lien affidavits and compared them to the facts presented. Evidently the affidavits claimed liens only against the owner's fee simple interest in the property. Not Body Bar's leasehold estate.

That's a big difference.

The Appellate Court first determined that in order to perfect a Texas Constitutional lien on the property owner, there must be a direct contract between the lien claimant and the property owner. There was no such direct link. Recall that Denco was engaged directly by Body Bar. Not Regency.

Next, the Appellate Court determined that in order to perfect a Texas statutory lien on the owner's fee simple interest as an "original contractor," there also must be a direct contract between the lien claimant and the property owner. Again, there was no such direct link. See above.

Denco then argued that Body Bar was acting as the agent for the property owner. Since liability imputes from agent to principal, this would have the desired effect of binding the property owner to the construction contract. And if that is true, then the lien affidavits were valid because Denco was dealing with the agent for the owner. And the actions taken by an agent bind the principal, absent unusual circumstances not at issue in this case.

Unfortunately for Denco, they submitted no evidence on that point for the Appellate Court to consider.

No surprises here. Not yet anyway. Here comes the surprise.

The Appellate decision implies that the lien affidavits should have attached to Body Bar's leasehold estate. That would be consistent with Texas law and appellate decisions. And then for some reason not explained in the Opinion, the Court does not indicate that Denco's liens were valid, but only as against Body Bar's lease.

Perhaps the lien filings were made late. Perhaps statutory notice of the filings weren't timely served. Maybe the lien filings made clear that Denco was only interested in a lien against the property owner's title, not Body Bar's lease. Maybe the Court did not feel the need to explain leasehold lien attachment theory further, since Denco was not going to be allowed to foreclose anyway. Perhaps I misread the Opinion. All of this is unclear.

The Appellate Court mostly agreed with the tenant Body Bar, but also gave Denco some relief too. See *Denco CS Corp v. Body Bar, LLC*; No. 06-14-11122-CV; Texas Court of Appeals, 6th District; January 8, 2015.

Lessons learned:

1. Contractors engaged by tenants routinely file liens when they get stiffed. Those liens, if completed properly, sent to the tenant timely, and if they otherwise satisfy all statutory requirements, are valid and attach to the tenant's leasehold estate.

2. Contractors or their lawyers will argue that the liens also attach to the property owner's fee simple estate. The theory is that since the improvements ultimately benefit the property owner, then the tenant was merely acting as the agent for the principal. And the principal was the landlord.

3. Practice Point: Whether representing a Texas landlord or tenant, know that payment and performance bonds can be purchased by the contractor to avoid a lien filing from attaching to any interest in land. Typically the cost is low, ~ 2% of the full construction cost. Either (or both) the landlord or the tenant might consider requiring their contractors to obtain and deliver the bonds before the contractors commence work at the job site. These could be obligations contained in the Lease and construction contracts.

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