

## How to Avoid Liability for a Tenant's Illegal Activities

by Lisa E. Spiwak, Esq.

A new trend is occurring whereby landlords are being held liable for the illegal activities of their tenants—regardless of the landlord's involvement in those illicit activities. This trend is extremely disconcerting and requires landlords to take unprecedented measures and exert significant efforts to protect themselves from liability exposure to court-awarded damages for their tenant's illegal activities.

No landlord wants to see illegal activity occur on its premises. However, the question arises as to what duty a landlord has to ensure that no illegal activity occurs on his premises. History indicates that landlords are not legally liable for damages caused by their tenant's illegal activities unless the landlord is aware of the activities and condones or facilitates them. Recent court decisions, however, are changing history and placing greater burdens on landlords in this regard.

### Luxury Brands Sue Landlords in Fight Against Counterfeiters

The lawsuit that started this trend in motion was the case of *Louis Vuitton Malletier v. Richard E. Carroll* in the Southern District of New York in 2005. In that case, Louis Vuitton secured a permanent injunction against a Canal Street landlord that had seven buildings of tenants selling fake Louis Vuitton products. The landlord could not dispute its knowledge of the illegal activities on the part of its tenants because it received five written notices from Louis Vuitton about the counterfeit activity on its properties and it did nothing about it. Pursuant to the court's order, the landlord was ordered to evict all of its tenants selling fake Louis Vuitton products, to post signs announcing that counterfeit sales are illegal, and to permit random inspections to ensure that the court's order was being followed. This became known as "The Landlord Program."

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The purpose of the Landlord Program is to curtail the sale of counterfeit products by targeting lawsuits against retail landlords as opposed to their tenant-sellers of the infringing goods. It prevents landlords from turning a blind eye to counterfeit sales and then avoiding liability for the illegal activity of their tenants by claiming that they did not know it was occurring. The luxury companies with protected copyrighted products find that going after the deep-pocketed commercial property owners that have a lot to lose is very effective in stopping the counterfeit trade. The tenants that are selling the counterfeit products do not have much to lose, and winning a lawsuit against them is an empty victory. They can just close up shop in one location and move down the block to a new location. They rarely have any attachable assets or expendable cash.

After the pivotal case by Louis Vuitton, the luxury leather-goods maker Coach followed suit and sued the owner of a famous flea market, Swap Shop, for failing to prevent its vendors from selling counterfeit goods on its premises. Swap Shop settled that lawsuit for \$5.5M. Other suits have followed.

The most recent case is that of Michael Kors Holdings suing the Mulberry Street Properties Corporation in the U.S. District Court Southern District of New York. The defendant owns a strip of storefronts in the Little Italy neighborhood of Manhattan and is being accused of turning a blind eye to tenants illegally selling counterfeit Michael Kors goods on its property. In the court papers, Kors charges that the building's landlord "continues to allow its premises to be used as a safe haven and marketplace from which counterfeiters can sell their wares."

Counterfeit goods have long been an issue for major fashion houses. Tory Burch LLC, which took a jewelry manufacturer Lin & J International to court for trademark infringement claiming it used Burch's trademarked "Isis Cross" design, was awarded \$38.9 million in damages and \$2.3 million in attorney's fees.

Clearly, the trend is for these large companies to go after the landlords that have deeper pockets than the tenants. So how can landlords protect themselves from being held legally liable for the illicit activities of their tenants?

### **Put Protective Language in Lease**

The best strategy for landlords to prevent becoming the next victim of the Landlord Program is to include protective language in their leases as well as to practice vigilance in their oversight duties. There are some essential provisions that must be included in a lease to protect the landlord.

**Use Restriction.** First and foremost, it is essential that the lease contain a Use Restriction paragraph. This verbiage not only dictates what purpose the premises may be used for, but also what it may *not* be used for. The lease should incorporate language that "no activity may be conducted on the

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leased premises that will result in the sale or storage of counterfeit goods or merchandise and that to do so will be considered a default of the lease giving the landlord the enforceable right to terminate the lease for a tenant's illegal use of the property.”

This Use Restriction paragraph can be tailored to include any illegal activities in addition to counterfeiting. A landlord that has an apartment building in a lower-end area may specifically include language to combat drug dealing or other criminal acts on the premises. Or a landlord that leases to massage parlors can specify that there can be no use of the premises for “illicit and illegal sexual activity.” The more specific the lease language is tailored to the tenant, the better.

**Landlord's Right to Enter the Premises.** Another important provision to include in the lease is the landlord's Right to Enter the Premises. A landlord must retain its unrestricted access to the premises to ensure that there are no illegal activities occurring on the property for which it could ultimately be held legally liable. It must also check that all federal and state laws are being upheld in relation to the operation of the tenant's business. This is extremely important lease language because a landlord can be held liable by the tenant's employees for safety violations on the premises if the landlord turned a blind eye to the violations or refused to make necessary repairs, etc. A landlord should demand regular inspections of the premises to adequately protect itself legally.

The landlord must ask whether the property is being maintained in a safe condition so that anyone visiting the premises or working on the premises is not being exposed to a dangerous situation. Are there any health hazards being created by the tenant's use of the premises? Are any state or federal laws being broken or compromised by the use of the premises? A landlord should put a covenant in the lease that requires the tenant to comply with all state and federal laws (including copyright and trademark in cases of possible counterfeiting). The lease verbiage should trigger a default of the lease in the event that the tenant fails to comply with the law.

**Indemnity.** Also, the lease should include an indemnity clause. This lease provision makes the tenant strictly liable for any illegal activities conducted on the premises and holds the landlord harmless for such activities. As we have seen from the cases that are now being decided in this area, it may be that the court refuses to hold the landlord “harmless” for illegal acts. Nonetheless, as a precautionary measure this language should be added to the lease.

Another protective clause for landlords to include in their lease is one that releases them from any liability for damages to the tenant by the stopping or interruption of its business arising from the landlord's actions to stop the illegal activity on the premises by the tenant. Normally, a landlord incurs

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liability if it prevents its tenant from conducting business and earning a living. However, when the tenant is engaged in illegal activity on the premises it waives all rights it would normally have. The lease language should waive any and all recourse against the landlord the tenant might otherwise have if the tenant is ordered to immediately vacate the premises or if it is ordered to immediately stop the illegal activity it is engaging in and which results in financial harm to the tenant.

**Default.** Lastly, an important clause to add to the lease to protect the landlord is a default clause that is specifically triggered by use restriction violations. This default clause should contain language to allow the landlord to immediately terminate the lease and immediately repossess the premises. There should be a specific exclusion of the tenant's right to cure. Further, the landlord should have language in the lease to provide it with damages for lost rent and early termination of the lease as a result of the illegal usage. This language should also include a provision for the recovery of all costs associated with the stopping of the illegal activity, including attorney's fees and court costs.

## Keep Eye on Tenant

In addition to making sure that the lease provisions adequately protect the landlord, the landlord must also take the necessary precautions to remain in touch with the tenant and with what is happening on the premises. A landlord will pay the price for being an absentee landlord.

The very best way to avoid criminal activity on the premises is to carefully screen tenants at the inception of the lease. This should include doing a background check, a credit check, and calling prior landlords for recommendations. If a landlord fails to adequately perform due diligence on a potential tenant, this can be seen as "turning a blind eye" to the tenant's propensity to engage in illegal activity and can later be used in litigation against a landlord to hold the landlord liable for the tenant's illegal activities.

Once the screening process is performed and the lease is executed, the landlord should communicate with the tenant about frequent site visits to the premises. The landlord should make it clear to the tenant from the beginning that it is going to monitor the tenant's activities. In fact, perhaps the landlord can set up a schedule of site visits from the onset so as to establish this as a routine. If the tenant is selling copyrighted items, the landlord should require a copy of the licensing agreement the tenant possesses to sell the merchandise from the manufacturer before the tenant can start selling the items on the premises. The landlord would also be well served to stay in touch with the neighboring landowners to get updates from them on what is going on with the tenant on the premises.

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### **Investigate Suspicious Activity Promptly**

If the landlord has any suspicion or indication whatsoever that there is illegal activity occurring on its premises, it must act immediately to stop the proceedings. This is exactly how the landlords on Canal Street lost their case against Louis Vuitton. They were put on notice of the sale of the counterfeit items on their premises and they did not act upon that information. Knowledge of the activity coupled with inaction on the part of the landlord is the basis for holding the landlord liable for the illegal activities of its tenant.

As the case law has established, the landlord does not have the luxury of hiding behind a screen of ignorance. The landlord must stay updated and knowledgeable about what is going on with the tenant's business and what goods are being sold through that business on the premises. There is also a certain amount of common sense involved. If the landlord has no positive information that its tenant is dealing in counterfeit goods, but it knows that its tenant is selling Louis Vuitton purses for \$30, then the court will hold the landlord liable for its tenant's illegal counterfeiting activities by virtue of the concept of reasonableness. It is reasonable to assume that the average person knows that a Louis Vuitton purse sells for significantly more than \$30.

Landlords are not able to purchase insurance to protect themselves against liability for the criminal acts of their tenants. A basic premise with insurance policies is that one cannot procure insurance against intentional tortious acts.

Ultimately, landlords no longer have the luxury of "turning a blind eye" to the activities occurring on their premises. They must remain involved, aware, and vigilant as to what is happening with their tenants on their premises or they risk paying the cost of not doing so, which is much higher! ♦

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