



KNOW WHAT YOUR TENANT IS SELLING When Tenants Sell Knock-off Goods, Landlords Pay

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Are landlords liable for what their tenants sell? Companies selling copyrighted products, such as Louis Vuitton, are successfully arguing that landlords are liable for facilitating their tenants' sales of counterfeit goods by knowingly looking the other way. Although landlords are generally not liable for the illegal activity of their tenants if they do not know it is occurring, landlords cannot turn a blind eye to counterfeit sales and then seek to avoid responsibility by claiming they had no knowledge that illegal activities were occurring on their property. This new approach to curtailing the sale of counterfeit products by targeting lawsuits against retail landlords, as opposed to the tenant-sellers of the infringing goods, is known within the industry vernacular as the "Landlord Program."

The rationale of the Landlord Program is to go after wealthy commercial property owners—landlords—who, unlike most tenants, have a lot to lose. Since tenants often do not have very much expendable cash, companies seeking to protect copyrighted products are now targeting the deep pockets of landlords, who they know are capable of paying judgments and settlements. Companies selling copyrighted goods also realize that landlords, unlike tenants, are tied to brick-and-mortar buildings. While a tenant that is shutdown in one retail location can easily reopen another shop down the block, a judgment against a landlord requiring it to evict all tenants found selling knock-offs has a more profound impact than simply moving the problem elsewhere. Put another way, companies selling copyrighted products have much more to gain from suing the retail landlord because the retail landlord has much more to lose.

Louis Vuitton Builds the Landlord Program

The novel lawsuit that first set the precedent for the Landlord Program was the Southern District of New York case of *Louis Vuitton Malletier v. Richard E. Carroll*, Case No. 05-cv-3331 (S.D.N.Y. 2005), in which Louis Vuitton secured a permanent injunction against a Canal Street landlord. The landlord could not dispute his knowledge that tenants in seven buildings he owned were selling Louis Vuitton counterfeits, as more than 8,000 fake Louis Vuitton products were seized from his buildings in a 12-month period, and given that he was sent more than five written notices from Louis Vuitton about the counterfeit activity on his properties. Pursuant to the court's order, the landlord agreed to evict all of his 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 be followed.

In January of 2006, a legal settlement was reached between Louis Vuitton and landlords for seven other Canal Street properties, in which the landlords promised the following: (i) to prevent tenants from selling handbags with counterfeit Louis Vuitton logos, (ii) to hang signs inside and outside their shops warning that the retailers are not authorized vendors of Louis Vuitton products, (iii) to finance and provide full access to court-appointed officials who would search the shops weekly for fake Louis Vuitton products for the next two years, and (iv) to evict tenants found selling fakes. Similar settlements have been signed by different landlords owning a total of 11 buildings on Canal Street, and, given that the contents of the agreements remain sealed, some speculate that Louis Vuitton also received financial compensation from the landlords.

The Landlord Program has already moved well beyond the narrow corridor that is New York City's Canal Street. In late 2005, a Chinese judge ordered a group of landlords in Beijing's Silk Market, which is well known for

its knock-off products, to pay monetary damages to Prada, Gucci, Chanel, Burberry and Louis Vuitton. Using these successful legal outcomes as leverage, it is only a matter of time before manufacturers of copyrighted retail goods pursue the Landlord Program in other cities with a sizeable presence in the counterfeit industry such as Los Angeles, Houston, Dallas, Chicago and Miami.

Prevention vs. Reaction—How to Avoid Being the Next Landlord Program Casualty

Unfortunately, there is no simple answer to the question of landlord liability when tenants sell knock-off goods. However, recent case law and private lawsuit settlements indicate that landlords are being required to take unprecedented action and to expend significant effort, time and money to stop the sale of counterfeit goods by tenants leasing space on their properties. Landlords increase their liability exposure to court-awarded damages, attorney fees incurred in defending such suits, and unbudgeted monitoring expenses, by reacting only after legal action has been initiated. For these reasons, retail landlords are more likely to realize the value of their commercial property by preventing the sale of counterfeit goods through careful lease drafting and vigilance.

Prevention Through Lease Drafting

There are several provisions that landlords should include in any base-form lease, which will give them the ammunition necessary to combat the sale of knock-off goods by their tenants. While consultation with an attorney on the precise language of the provisions is strongly recommended, some suggested provisions to aid the landlord are as follows:

1. *Restrictions on Use.* The first type of provision that bears discussion is a "use restriction." A typical use restriction allows the tenant to make certain uses of the leased premises. However, it can also prohibit the tenant from making other uses of the premises. It could, for instance, prescribe that (i) no activity will be conducted on the leased premises that will constitute the sale, lease, or other hypothecation of counterfeit



goods or products; and (ii) the leased premises will not be used for the storage of counterfeit goods or products, and that the tenant will not permit any counterfeit goods or products to be brought onto the leased premises. Such a provision, if tied to the default provision, can provide a contractual basis—enforceable regardless of the case law or statutes of the state where the property is located—for a landlord to terminate the lease for a tenant's illegal use on the property.

2. *Tenant Compliance With Laws.* There should be a covenant in the lease that requires the tenant, along with the tenant's employees and agents, to comply with all applicable laws including, without limitation, any and all state and/or federal copyright and/or trademark laws—whether created by statute or judicially made. The drafting also should trigger a default so that a violation of such provision enables the landlord to exercise its remedies under the lease.
3. *Right of Entry.* A right-of-entry provision should give the landlord the right to reenter the premises to cause the tenant to comply with applicable laws, and to remove any and all counterfeit products to ensure compliance. However, the right-of-entry provision should state that the landlord has no duty to do so.
4. *Indemnity Provisions.* Another protection for the landlord, which is only as valuable as the tenant's ability to perform it, is an indemnity from the tenant in favor of the landlord. The landlord rarely will have insurance coverage for intentional acts resulting from the tenant's sale of counterfeit goods. Therefore, a landlord may want to consider requiring that the tenant provide an indemnification that makes the tenant strictly liable for such illegal activity.
5. *Release Clauses.* A "release" or exculpation clause is an agreement by which one party agrees not to seek recourse against the other party to the contract for damages or losses suffered or incurred by the releasing party. It results in a shifting or limitation of one party's risk by contracting for the release in advance of the occurrence. This mechanism can be used to protect the landlord from any claims by the tenant for the loss or interruption of the tenant's business arising from the

landlord's efforts to stop illegal activity, such as the sale of counterfeit goods.

6. *Default Provisions.* Landlords should typically not rely on standard default and remedy provisions for dealing with the sale of counterfeit goods. In most leases, this situation would fall into the "other non-monetary default" catch-all provision, which often allows as much as 30 days for initiation (or completion) of cure and, perhaps, contains a provision stating that the tenant has such longer period as may reasonably be necessary in the exercise of prompt and diligent efforts to cure. There may be no provision dealing with the chronic, repeated nature of this activity, the dire consequences of defaults or the potential defaults relating to the sale of counterfeit goods, and the need for speed in dealing with this problem before it escalates. The default provision of the lease should be triggered specifically by use restriction violations and should permit the landlord to terminate the lease and immediately repossess the premises, without the necessity of giving the tenant an opportunity to cure (unless expressly required by state law). The provision also should reserve the landlord's right to damages for lost rentals due to early termination of the lease, and the recovery of all costs, including attorney fees, for stopping the illegal use.

Prevention Through Vigilance

Not one of the foregoing lease provisions dealing with the illegal sale of counterfeit goods will be of any value if landlords fail to monitor their tenants vigilantly to ensure compliance. There are several steps that landlords should thus take to help protect against liability exposure from tenants selling knock-off goods:

1. *Monitor Tenants' Activities.* First and foremost, landlords need to take steps to monitor the activities of their tenants. Landlords have legitimate reason to fear being sued for turning a blind eye to tenants that are selling knock-off goods on landlord properties. Landlords should take precautions, such as careful screening of tenants and, perhaps, barring them from subletting without express written consent.
2. *Stay Educated.* As the recent case law and private lawsuit settlements make clear, the argument that a landlord merely provides a

place for counterfeit goods to be sold will not protect a landlord from liability. Therefore, landlords need to know not only about the real estate business, but also about the goods being sold by their tenants. What is the most obvious indication that an item is a knock-off? Price. If the price seems too good to be true, it probably is a counterfeit item.

3. *Act Quickly.* Most importantly, to avoid liability, landlords need to act quickly when they discover illegal activities on their properties. Knowledge, coupled with inaction, is all that is needed for companies selling copyrighted goods to hold landlords liable. While a written letter from a company notifying a landlord of counterfeit activity will clearly suffice, the landlord can also be held liable if it is common knowledge that illegal activities are occurring on the premises. Landlords, therefore, need to be aware of the hubs of counterfeit activity throughout the United States, such as those in New York, Los Angeles, Houston, Dallas, Chicago and Miami.

Landlords' Legal Rights and Remedies When Tenants Sell Knock-off Goods

The Landlord Program makes clear that landlords who lease property to tenants knowing that the premises will be used for an illegal purpose, or that landlords who turn a blind eye to such activity, can be held liable if their tenants sell knock-off goods. However, when a landlord that is reasonably unaware of an illegal use discovers such activity on its property, §12.5 of the Restatement (Second) of Property provides rights and remedies for the landlord against the tenant engaged in illegal activity:

If the tenant uses the leased property for a purpose that is illegal and the landlord is not a party to that illegal use, the landlord may (1) terminate the lease, if he does so while the use is continuing, or if he does so within a reasonable time after the use is stopped by public authorities, and recover damages; or (2) hold the tenant to the lease and obtain appropriate equitable and legal relief, including recovery of damages.

Although §12.5 is in accordance with the common law and statutes of many states, its applicability varies dramatically from state to state. A landlord should always consult with an attorney in determining the rights and remedies available to it under applicable law.

When a landlord discovers that a tenant is using the leased property for an illegal purpose,



under §12.5, the landlord can choose to either (i) terminate the lease and recover damages, or (ii) hold the tenant to the lease and recover equitable and legal relief, including damages.

The first option is only available to landlords while the illegal use is still in progress or shortly after such use is stopped by public authorities. As for damages, under the first option, the measure is the loss to the landlord of rentals due to early termination of the lease. Under the second option, damages include the costs of stopping the illegal use, as well as equitable relief, such as an injunction ordering the tenant to cease the illegal activity.

Landlords must realize that these rights and remedies are only available when the landlord is not involved in the illegal activity. However, courts are quick to find that landlords are contributing to the illegal use—and thus the

benefits of §12.5 are not available—when landlords turn a blind eye to such activity.

Conclusion

Landlords that provide a safe haven for their tenants to engage in the sale of counterfeit goods risk becoming the next casualty in the war on knock-offs known as the Landlord Program. Recent case law and private lawsuit settlements demonstrate the extraordinary and unexpected costs of ignoring the issue, and reacting to stop the problem only after an action has been initiated. To minimize such liability exposure, landlords should take preventative steps when drafting the lease, and should remain proactive throughout the term of the lease. Most importantly, in order to preserve their rights and remedies against tenants who engage in the sale of knock-off goods, landlords

need to monitor their tenants vigilantly and respond quickly if and when illegal activity is discovered on their properties. ■

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