Payment Fraud Risk Allocation in Commercial Leases

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Commercial leases are built around allocating risk. They address everything from casualty and condemnation to environmental liability and compliance with laws to name a few areas. But many leases still overlook a risk that has become increasingly common: payment fraud.

A Growing Risk in Commercial Leasing

Business email compromise, phishing attacks, and other cyber-enabled fraud schemes are no longer isolated events. Fraudsters routinely intercept or imitate legitimate email communications and redirect rent payments by sending fake wiring or ACH instructions.

When that happens, a simple question becomes surprisingly difficult to answer: Who bears the loss?

Too often, the lease doesn't say.

The Allocation Problem

In the absence of a contractual allocation, the parties are left to litigate under common law principles that were never designed for modern payment fraud. Courts may reach different conclusions depending on the facts and the jurisdiction, making the outcome uncertain and the cost of resolving the dispute significant.

A commercial lease should eliminate uncertainty, not create it.

Five Issues Every Lease Should Address

A short payment fraud allocation provision can establish clear expectations before a loss ever occurs. At a minimum, consider addressing the following:

- **Who bears the risk.** State which party is responsible for a fraudulent or misdirected payment and when payment is considered made, such as only after the landlord actually receives good funds.

- **How payment instructions may be changed.** Require any change to wiring or payment instructions to follow a predetermined process and be confirmed through a live telephone call to a previously verified phone number, not one included in the email requesting the change.
- **Who is authorized to communicate payment information.** Identify designated representatives and approved communication channels so that an unsolicited email alone cannot alter payment instructions.
- **When revised instructions may be relied upon.** Make compliance with the verification procedure a condition to the effectiveness of any change in payment instructions.
- **What happens if fraud is discovered.** Require prompt notice and mutual cooperation with financial institutions and law enforcement in an effort to recover the funds.

Planning Ahead Before Fraud Occurs

Payment fraud is no longer a remote or emerging risk. It is a recurring issue in commercial real estate transactions and one that deserves the same attention as any other material allocation of risk in a lease.

A well-drafted payment fraud provision costs nothing to negotiate but may prevent a costly dispute later. As payment fraud schemes evolve, landlords and tenants should consider making payment fraud allocation and verification provisions a standard part of every commercial lease.