

Ignorance is Not Bliss: Exploring Environmental Risks in Lease Transactions



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Landlord-Tenant Hypothetical (Part I)

- ▶ Disordered Developer LLC (DD) owns a 5 acre parcel of land (the “Land”).
- ▶ Prior to DD’s acquisition of the land, the Land was used for a manufacturing facility that burned down and was razed.
- ▶ The prior owner stored fuel for its facility in above ground and underground storage tanks. The above ground tanks were removed when the former building was razed.
- ▶ DD acquired the Land for a ‘steal’ in a foreclosure sale. DD did not do much diligence on the Land as DD also owns a 10 acre parcel of land adjacent to the Land and the prior owners were ‘always good neighbors.’



Landlord-Tenant Hypothetical (Part II)

- ▶ DD currently operates an auto repair shop on the adjacent parcel of land and there are uncovered dumpsters along the property line shared with the Land. Additionally, a creek runs across both parcels.
- ▶ DD wants to ground lease the Land to Thoughtful Tenant LP (TT).
- ▶ TT intends to construct its second manufacturing/distribution facility on the site. TT owns the land where its other facility is located.
- ▶ DD has submitted a lease draft to TT for the Land and is pushing for a quick negotiation and signing.



Consultant Observations & Concerns

- ▶ Property obtained through bank foreclosure and bank unlikely to have much knowledge about previous operations at the site.
- ▶ Hazardous materials and/or petroleum products used in daily operations could have been mishandled (e.g. spilled/released). The types of materials, duration, handling practices, and vintage of the operation all factor into the likelihood that a release occurred.
- ▶ Underground storage tanks (USTs) are one of the most common sources of contamination to the subsurface.
- ▶ Potential for release may be increased as a result of the fire.
- ▶ Potential for impact to site from DD's adjacent auto repair operation.
- ▶ Intended future use may include similar materials as the previous operation. Establish baseline of current environmental conditions to support a defense if future release is discovered.
- ▶ Since TT intends to develop the site, there are also construction and land use considerations, such as impacted media requiring special handling, disposal methods, or land use controls.

Due Diligence Investigations

- ▶ Phase I Environmental Site Assessment (ESA)
- ▶ Review of EPA Envirofacts
- ▶ Owner/Landlord environmental questionnaire
- ▶ Regulatory database review
- ▶ Chain of Title search, environmental lien and AUL search
- ▶ Asbestos, lead, and household hazardous waste inventory for remnants of razed structure
- ▶ Phase II ESA
- ▶ Geophysical investigation to assess potential for orphan underground storage tanks (USTs)



Due Diligence Investigations: Landlord-Tenant Concerns

▶ Landlord

- ▶ Historical information disclosed
- ▶ Don't want to know current condition
- ▶ Not responsible for prior operations
- ▶ No remediation obligation
- ▶ Rent based on 'AS IS' deal
- ▶ Too much time

▶ Tenant

- ▶ Understand historic use
- ▶ Understand current conditions
- ▶ Differentiate releases
- ▶ Use to allocate risk in lease
- ▶ Address issues up front
- ▶ Weigh costs/risks



Proposed Lease Terms: Representations, Warranties, Release, and Indemnity

- ▶ Representations and Warranties: the Land is being leased “AS IS” with no representations or warranties
- ▶ Release: TT releases DD from any and all claims related to the Land
- ▶ Indemnity: TT will indemnify DD from any and all claims related to the Land and improvements



Proposed Lease Terms: Permitting, Compliance and Net Terms

- ▶ **Permitting:** TT is solely responsible for the construction of its facility and obtaining all required permits related thereto
- ▶ **Compliance:** TT is responsible to comply with all applicable laws related to the construction, use, and operation of its facility
- ▶ **Net Terms:** the Lease is fully 'net' to DD



Questions?

