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Client Alert

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New EPA Guidance Gives Long-Term Tenants Direct Access to the Bona Fide Prospective Purchaser Defense and Greater Protection from Liability for Historical Contamination

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Newly issued guidance by the U.S. Environmental Protection Agency (USEPA) suggests that prudent long-term tenants of commercial and industrial properties should conduct environmental due diligence before entering into a lease, and that lenders who are looking to a tenant's interest in a lease as security for a loan should ensure that the loan documents require the borrower-tenant to provide all legally required notices, cooperate with environmental authorities, and take reasonable steps with respect to hazardous substance releases.

The liability of "innocent" tenants under environmental laws is limited, but real. The Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. § 9601 *et seq.* (CERCLA), imposes liability on "owners" and "operators," categories which typically do not include a tenant that had no role in causing a contamination problem. However, a tenant may become liable for historical environmental problems either by controlling the property to such an extent that it is deemed a "de facto owner," or by exercising a level of control over the remediation of the hazardous substances at issue to such a great extent that the tenant becomes an "operator" under CERCLA, and, by extension, California law.

The risk is particularly acute for ground lease tenants and for tenants in sale-leaseback transactions. When deciding whether a tenant is a "de facto owner" courts look for indicia of ownership, and long-term leases which effectively turn over control of the property to the tenant have been held to satisfy this test. An "innocent" tenant also may become liable as an "operator" if it exacerbates the contamination (for example during construction) or exercises control over the remediation or management of hazardous substances. Ground lease tenants are likely targets for liability as either a de facto owner or an operator.

Federal and California environmental laws provide liability protection for parties who qualify as "bona fide prospective purchasers" (BFPPs). [See, CERCLA § 101(40).] Generally speaking, to obtain BFPP protection an owner must conduct "all appropriate inquiries" into the previous ownership and uses of the property prior to closing, demonstrate that all contamination occurred prior to its acquisition of the property, provide all legally required notices, cooperate with regulators, and take reasonable steps with respect to hazardous substance releases. Tenants can obtain BFPP status derivatively through the owner, provided the owner complies with all requirements of the statute.

The statutory BFPP rule, however, leaves a long-term tenant in jeopardy if the owner does not conduct all appropriate inquiries prior to closing or fails to comply with post-closing obligations, such as notice requirements. Guidance issued by the USEPA on December 5, 2012 is intended to give tenants control over their own BFPP status, and thereby facilitate the redevelopment of contaminated properties.

The guidance memorandum, entitled "Revised Enforcement Guidance Regarding the Treatment of Tenants Under the CERCLA Bona Fide Prospective Purchaser Provision," provides that a tenant may protect itself from losing BFPP status by complying with all requirements that are imposed on an owner seeking to qualify as a BFPP. Although a tenant is not required under the new guidance to conduct its own "all appropriate inquiries" (AAI) into previous ownership and uses, a prudent tenant should, before signing a long-term lease, either review the owner's environmental due diligence and satisfy itself that the owner has satisfied the AAI standard, or conduct its own AAI-compliant environmental due diligence. Tenants also should carefully follow any recommendations regarding waste handling and remediation and be prepared to demonstrate that they have taken reasonable steps with respect to hazardous substance releases. The newly issued guidance is applied by the USEPA on a site-specific basis, but it nevertheless provides useful information to ground lease and sale-leaseback tenants on how to protect themselves from liability for historical contamination.

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