

INSIDE...Environmental liability information
for property owners and tenants

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Liability Protection for Property Tenants and Owners

Six-Part Environmental Audit Process Is Essential in Lease Transactions

By Rosalie Skefich

Commercial and industrial property owners and tenants beware. You may unknowingly be exposing yourself to unnecessary environmental liability. Under existing environmental regulations, financial damages may be assessed to present and past tenants and property owners for residual environmental contamination. The property owner may be responsible for the condition without regard to fault, and innocent tenants may be named in lawsuits involving clean-up costs. Some case histories help illustrate the potential problems.

Case History 1:

A tenant's manufacturing operation generates a lead-containing dust as part of a ceramic manufacturing process. The lead dust disperses throughout the facility, including to the heating and air conditioning system, roof, and nearby soils. The tenant leaves the building. A prospective tenant has the dust sampled and analyzed. The results indicate high lead levels unsafe for employee exposure. Because the previous tenant's lease agreement did not include provisions for environmental impairment to the property, the property owner may be responsible for the cleanup.

Case History 2:

A tenant recycler of de-ionized water resin cylinders generates an acidic waste stream that is discharged untreated into the city sewer. The facility sewer pipe has corroded and has caused underground soil contamination. Environmental investigations, sampling programs, and clean-up activities, amounting to tens of thousands of dollars, are required. The tenant believes the owner should have provided the facility with the proper piping, and is, therefore, responsible for the costs. The owner claims he was unaware of the facility operations, and believes that the tenant should pay the costs.

Case History 3:

A tenant electronic printed circuit facility uses nickel and cyanide electroplating baths in its manufacturing process. The circuits are rinsed in a sink connected to the city

sewer. In addition, the operator pays little or no attention to spills and overall housekeeping. During floor washdowns, the bath spills flow to floor drains and out to the storm sewer system. The city waste water treatment facility notices unusually high levels of nickel and cyanide contaminants in their incoming stream and traces the source back to the printed circuit facility. The city public works department maintaining the storm sewer confirms the source of contamination. The tenant has since moved from the facility, and gone out of business. The property owner may now be liable for the past wastewater discharge violations.

Would you like to avoid these unwanted scenarios?

Help is available through use of the Tenant Environmental Audit process, which consists of six steps.

1 Pre-Lease Questionnaire

A prospective commercial or industrial lease tenant should be asked by the property owner to complete a Pre-Lease Questionnaire to identify hazardous materials used, hazardous wastes generated, material transfer operations, housekeeping procedures, and employee training programs for materials management. This document serves both to inform the property owner of the proposed operations and to protect the tenant from involvement in future problems in which he is not involved.

2 Baseline Audit

An environmental baseline audit of the property is essential for either the property owner or the tenant to be eligible for the “innocent purchaser” defense under federal law. This type of audit is not necessarily a property owner’s review of the tenant’s compliance with applicable laws and regulations; rather it is an abbreviated compliance check and review of the tenant’s operations and the potential for leaving residual contamination behind. At the same time, the baseline audit should review the past use of the lease site and adjoining properties so that the tenant may be protected from future environmental liability cases involving previous tenants. The tenant may also want to consider investigating the property owner’s means to clean up substantial environmental problems.

The baseline audit is particularly important in states such as California where law requires a property owner to give notice to prospective tenants if he or she knows or “has reasonable cause to believe” that a release of a hazardous substance is located on or beneath the property. The law also requires tenants to notify their property owners any time a release or a suspected release of a hazardous substance is located on or under the property. Typically, these reporting requirements are included in the lease agreement. In California, failure to provide such written notices can lead to financial civil penalties of up to \$5,000 for each separate willful violation.

3 Lease Agreement

Once the baseline audit is complete, a lease agreement is prepared or modified to help maintain the environmental integrity of the property and protect both the property owner and tenant from unnecessary liability. Remedies to issues identified during the baseline audit are typically included in the agreement along with enforceable conditions that detail action items and schedule for tasks assigned to each party. At a minimum, the property owner should require the tenant to comply with all applicable laws, including environmental laws. Environmental attorneys may be helpful in drafting or reviewing contract language for leases, property transactions, or deeds.

4 Re-Inspection

Annual re-inspections of the tenant’s operations are an important pro-active tool to help protect the property owner and the tenant. The frequency of the inspections should increase depending on the amount of hazardous materials, how they are used, and the enforcement history of the tenant. Some may argue that the costs of these re-inspections should be shared between the property owner and the tenant.

5 Exit Audit

Property owners should not wait until the week before the tenant leaves to conduct the exit audit. Such an audit is best conducted at least six months before the tenant’s departure to allow time to manage any issues that may be identified. It is becoming more common for tenants to request that property owners issue the departing tenant a “clean bill of health” so that they will not be brought into any litigation regarding environmental impairment identified on the property at a future date. Such assurance cannot be issued without first conducting an exit audit.

6 Management of Issues

Using the enforceable conditions of the lease agreement, issues identified during the exit audit are resolved prior to the tenant’s departure. Here again, environmental attorneys may be helpful in apportioning costs among the potentially responsible parties.

The Tenant Environmental Audit process can help protect both property owners and tenants from the financial burdens associated with past non-compliance activities or clean-up of environmental releases to property. While tenants should strive to assure property owners of environmentally responsible operations, property owners should consider the risks associated with leasing to tenants with unacceptable materials management procedures.

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