BLANK ROME LLP
COUNSELORS AT LAW

JULY 2015 • VOL. II, ISSUE 2

REAL ESTATE

FOUNDATION

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INSIDE

THIS ISSUE

A Note from the Chairs

BY PELAYO COLL AND SAMUEL M. WALKER

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With this third edition of our newly revamped *Foundation* newsletter now published, we wanted to take the opportunity to thank you for your interest in our articles. There are many sources available these days, given the extensive, and sometimes overwhelming, amount of information now available on the Internet, so we wanted to let you know that we value your readership and loyalty.

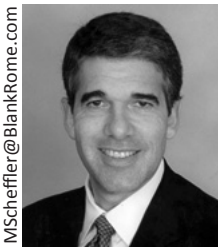
We also appreciate your feedback, so please let us know if you have any comments or suggestions.

We wanted to further note that Blank Rome's real estate group continues to be busy in all facets of our practice. This year has been extraordinary in terms of the amount and types of transactions on which we are working, and we have highlighted some of them in our "Noteworthy Deals" section on page 11. In addition, we are honored to have once again been ranked so highly in *Chambers USA*, which gave our real estate practice and attorneys top-tier recognition for 2015 (see page 6 for a full listing). As *Chambers* relies heavily on the feedback they receive from our clients, peers, and industry professionals, we are very proud of our continued high position in these rankings.

There is therefore no better time than to personally say "thank you" to our clients for the opportunity to work with you. We are grateful for the trust you place in us, and look forward to continuing to provide you with quality legal services.

Warranty/Guaranty Provisions in Construction Contracts

BY MICHAEL A. SCHEFFLER



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The most confusion I have seen in the discussion of construction topics concerns the concepts of "warranty" and "guaranty." This article will address the confusion, explain the important distinctions between these two concepts, and describe how to effectively administer and enforce warranty and guaranty provisions in construction contracts.

Warranty

In a typical construction contract warranty provision, the contractor "warrants" or "represents," or covenants, that its work will be performed in accordance with certain standards stated in the contract (e.g., in "a good and workmanlike manner") and otherwise be free of defects and in conformity with the design documents. While the term "warranty" or "warrants" is often used in connection with this concept, it really pertains to any provision in the contract, whether a representation or a covenant, which prescribes a standard of performance governing the contractor's work.

The remedy for breach of the "warranty" is the recovery of monetary damages incurred by the other party (e.g., the project owner or general contractor) by reason of the breach. So, for example, if defective materials need to be repaired or replaced by the owner, the owner is entitled to recover from the contractor the cost of the repairs or replacement made by the owner.

The duration of the warranty will sometimes be designated in the contract (or design specifications), but if not, the statute of limitations period for contract breaches will constitute the time frame for enforcement (in New York, for example, the period is six (6) years from the accrual of the cause of action).

Guaranty

A typical guaranty (or guarantee) provision becomes operative after completion of the contractor's work, and requires the contractor to return to the project site to repair or replace defective or non-conforming materials or equipment, or remedy improper workmanship, at its own cost and expense.

The contract, or design specification, containing this obligation generally provides for an expiration date or period beyond which the guaranty is no longer enforceable. The design specifications may contain certain guaranty time periods that are longer than the time period provided for in the contract, so it is important to state in the contract that the longer period prevails.

The term "guaranty" may not be used to characterize this obligation, and often the word "warranty" is used, which can generate confusion because of the different remedies available under a true "guaranty" and a true "warranty."

Confusion

The confusion surrounding the different concepts of "warranty" and "guaranty" can create the following problems in drafting or enforcing the construction contract:

- As stated earlier, the term "warranty" may be used when, in fact, the so-called "warranty" is really a "guaranty." So, for example, the contract may state that the contractor "warrants that the materials will be free from defects and that the contractor will repair or replace any defective materials within two (2) years after completion of the work." The first part of this provision is a true "warranty," but the second part is really a "guaranty." By conflating these two concepts in one sentence, the drafter has created uncertainty as to the time period for enforcement of the true "warranty"—is it two (2) years or the statute of limitations period for breach of contract (in New York, six (6) years)? If the

(continued on page 3)

When assessing the contractor's responsibilities, the enforcing party should make sure it reviews any warranties or guaranties contained in the design specifications, in addition to those set forth in the contract.

Warranty/Guaranty Provisions in Construction Contracts
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first part of the sentence were segregated from the second part, into two different provisions, as shown below, there is no doubt that the enforcement period for the warranty remedy (i.e., recovery of damages) is the statute of limitations period:

  - "The contractor warrants that the materials will be free from defects."

  - "If any materials are found to be defective within two (2) years after completion of the work, the contractor will repair or replace said materials."

- The term "guaranty" may be used, mistakenly, instead of the term "warrant," which can result in a contractor "guarantying" that the work will be performed in a good and workmanlike manner and otherwise be free of defects and in conformity with the design documents. That might be fine by itself, but because the drafter was thinking that the provision operated as a "warranty," important "guaranty" elements may have been omitted (such as, for example, the obligation to commence repairs within a designated time frame and prosecute the repairs to completion, and the obligation to replace inherently defective materials).

- On the other hand, the terms "warrant" or "represent" may be used instead of "guaranty" or other covenantal language, which may limit the owner's remedy to the recovery of damages for breach of the warranty or representation, whereas the owner may have thought that it could require the contractor to return to the site and correct the defective work.

Enforcement of Warranties and Guaranties

The other party to the construction contract is entitled to enforce the contractor's guaranty or warranty, as well as any other party who is named as a beneficiary of the guaranty or warranty provisions (e.g., the owner, if the contract is with a subcontractor) or to whom the contract (or separate guaranty or warranty document) has been assigned.

When assessing the contractor's responsibilities, the enforcing party should make sure it reviews any warranties or guaranties contained in the design specifications, in addition to those set forth in the contract.

It is also important to note that if the warranty breach is discovered during the "guaranty" period, the breaching party should be given the opportunity to remedy the defective work; otherwise, that party may have a defense to a damage claim under the warranty provision (at least to the amount of damages sought), arguing that it could

have mitigated the damages if it had corrected the defect itself. After the guaranty period has expired, there is no obligation to afford the breaching party the right to repair the work itself, but there may be business or practical reasons to do so.

The owner is, of course, the direct beneficiary under the guaranty and warranty provisions in the prime contract (i.e., the agreement with the General Contractor ("GC") or Construction Manager ("CM")), and the prime contract should require that the owner be named a third-party beneficiary under the guaranties and warranties provided by each subcontractor (whether in its subcontract or a separate warranty/guaranty document). The owner should have the option of enforcing its rights against the GC/CM or the subcontractors. If the owner elects to go directly against a subcontractor while its warranty or guaranty rights against the GC/CM have not yet lapsed, it would be advisable to involve the GC/CM in the process in order to preserve its warranty and/or guaranty claims against the GC/CM. In fact, the prime contract should provide that the GC/CM must, at the owner's discretion, either enforce the warranties or guaranties against the subcontractors or assist the owner in its prosecution of the warranties or guaranties.

Even though the owner will have recourse against the GC/CM, it is important for the following reasons that the owner ensure that the warranty and guaranty benefits it expected to receive from the subcontractors are actually memorialized and the documents granting such benefits are secured by the owner for its files:

- the warranty or guaranty periods in the prime contract may be shorter than the periods afforded by a particular subcontractor;
- if the GC/CM becomes bankrupt or otherwise ceases operations, the only recourse available to the owner may be against a subcontractor; and
- there may be an independent business relationship between the owner and the GC/CM, making it inadvisable for the owner to seek recourse against the GC/CM.

Conclusion

It is essential that owners, contractors, and their lawyers understand the key distinctions between warranties and guaranties, and are mindful of these distinctions in drafting and enforcing the prime contract or subcontract. □

Leasing Tips for Commercial Landlords and Tenants: Who Owns the "Fixtures" When the Lease Expires?

BY CHRISTOPHER TESAR

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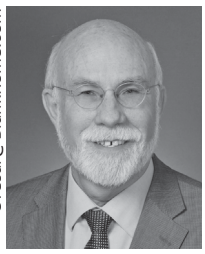

CHRISTOPHER TESAR
COUNSEL

When a lease expires, it is not uncommon for landlords and tenants to dispute what constitutes the landlord's property and what constitutes the tenant's property, even when sophisticated parties and equally sophisticated leases are involved. Ownership disputes also can arise when the tenant defaults and the landlord sues to terminate the lease and recover possession of the premises. What constitutes the "premises" is not always as clear as one might think, however. Finally, ownership disputes can arise in the context of a bankruptcy when creditors, including the landlord, the tenant, and the trustee, contest ownership of the tenant's assets.

Some Basic Principles

Land and buildings are quintessentially "real property" and revert to the landlord when a lease expires or is terminated. Except in rare instances, there is no dispute over who owns the land and the building. The ownership issue is less clear when it concerns tenant improvements and installations that are substantially integrated into the premises, such as complex refrigeration systems, extensive boiler systems (and related distribution lines, pumps, and water-softening tanks), wall-mounted forklift charging stations, pallet racking, and similar equipment in an industrial facility. Are these items the tenant's personal property that the tenant is entitled to remove, or are they so integrated into the building that they constitute a part of the landlord's reversionary interest in the premises?

State law generally provides definitions and basic principles that eliminate simple cases. Property is either "real property" or "personal property." Real property is "immovable" and includes land and buildings. Personal property is "movable" and includes furniture, fixtures, and equipment the tenant uses in its trade or business and is entitled to remove at lease expiration. Such personal property usually is defined as a "trade fixture." Unfortunately—and the source of almost all ownership disputes in this area—real property also includes property that in fact can be

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Leasing Tips for Commercial Landlords and Tenants: Who Owns the "Fixtures" When the Lease Expires? (continued from page 4)

removed but is "affixed" to or "imbedded" in the land or a building to such an extent that it cannot be removed without "injury" or "damage" to the land or building. Such hybrid property commonly is defined as a "fixture." Leases sometimes embellish these definitions and basic principles. For example, injury or damage upon removal often must be "material" for an item to be characterized as a real property fixture rather than a trade fixture. However, "materiality" is of limited assistance when each side is motivated to leverage any lack of objective certainty to its advantage. The party that paid for the item does not necessarily prevail in these disputes. Most state laws and sophisticated leases provide that even an item that otherwise might be a trade fixture before it is installed becomes the landlord's property at lease expiration or termination if it is sufficiently attached to or incorporated into the premises.

The lease negotiation stage usually presents the best opportunity to address the personal property "trade fixture" vs. real property "fixture" challenge.

One Landlord's Unfortunate Experience

The author is familiar with an unfortunate case in which a private equity fund subsidiary purchased a very large, FDA-certified refrigerated food-processing facility. The tenant, also a private equity fund subsidiary, had purchased the food-processing business from the original founders of the enterprise. A long-term lease between the founders' land-holding entity and their operating entity was in place at the time of all the purchase and sale transactions. Accordingly, neither party to the lease was an original participant in the creation of the landlord-tenant relationship. Within a relatively short time, the tenant went into bankruptcy.

The landlord obviously was distressed to lose its tenant, but became even more distressed when the trustee in bankruptcy claimed that all the boilers, refrigeration coils and compressors, water-softening equipment, and many other items the landlord considered necessary to operate the facility as an FDA-certified refrigerated food-processing facility, were removable trade fixtures and not owned by the landlord. In theory, all these items could be removed, though in some instances it would be a major endeavor and significant repairs would be required. Moreover, without these items, the facility could not be operated as a food-processing facility, which had been the facility's intended purpose since construction. The bankruptcy trustee elected to litigate ownership. Knowledge of who had paid for and installed the contested property might have helped the tenant, but neither the tenant nor the landlord was an original party to the lease. Documentary evidence, such as purchase invoices and depreciation schedules, was sketchy. In any event, the lease provided that "fixtures" became the landlord's property at lease expiration or termination. The landlord made the business-driven decision to settle, paying $2.5 million for equipment affixed to and, in many cases, imbedded in the premises that was integral to its operation for its intended purpose. Now, the landlord had no tenant and, in its mind, had paid $2.5 million to "purchase" its own property!

Some Practical Suggestions to Manage Uncertainty

Can situations like this be avoided, or at least mitigated? In the example above, neither party could do much about the lease itself since it already was in place when they came upon the scene, but the lease negotiation stage usually presents the best opportunity to address the personal property "trade fixture" vs. real property "fixture" challenge.

The following are some suggestions for landlords and tenants:

- It is extremely difficult to craft definitions of key terms sufficiently well to eliminate disputes, but the likelihood of disputes can be reduced with thoughtful drafting. For example, the landlord in our illustration would have had a stronger case if the lease had provided that fixtures that are necessary to the operation of the building for its intended purpose, constitute landlord's property regardless of when it was installed or by whom. Alternatively, a tenant would want fixtures to remain its property unless removal caused damage that could not (reasonably) be repaired.

- When possible, it is useful to list and categorize existing or to-be-installed items that are highly susceptible to controversy in a schedule to the lease. The landlord burned in the example above insisted on extensive scheduling of "landlord's property" and "tenant's

property" when it finally found a replacement tenant. The landlord also took advantage of the opportunity to include extensive provisions relating to the maintenance, repair, and replacement of scheduled items, including detailed language regarding the tenant's right to abandon items that no longer were of productive use and who owned "landlord's property" that the tenant replaced during the lease term. These precautions benefited both parties by providing some clarity.

- The landlord in the illustration above had the facility carefully inspected at the time of purchase, but it did not incorporate the information in the inspection report into the purchase agreement in any effective way. For example, the landlord did not include a schedule of "landlord's property" adequately supported by one or more seller representations and warranties. The survival period of the representations and warranties and related indemnity provisions may not have been sufficient to provide a remedy against the seller when the actual dispute with the tenant arose but, if nothing else, scheduling with supporting representations and warranties would have compelled the parties to pay attention to these issues, thereby reducing the likelihood of them arising unexpectedly in the future. A buyer of a business operated from leased premises can make similar good use of inspections, scheduling, and representations and warranties to protect its position.

- The landlord also obtained an estoppel certificate from the tenant, but the certificate addressed "customary" matters such as term expiration date, rental rate, rent adjustments, options to extend the term, and whether any defaults existed. Although a buyer cannot abuse a tenant by demanding confirmation of information well beyond custom and practice, some lease provisions on the subject of the tenant's obligation to provide estoppel certificates contain omnibus language that may afford the opportunity to include at least some useful information on the subject of landlord's property and tenant's property. From the buyer-tenant perspective, the document evidencing the landlord's consent to the lease assignment or sublease of the premises can be crafted to include confirmation of the status of fixtures that may become the subject of lease-end disputes.

- Typical lease provisions regarding the landlord's prior consent to the tenant's installation of fixtures and trade fixtures also can be helpful to both landlords and tenants. In industrial facilities, tenants often negotiate for broad authorization to alter and improve the premises but, even if the landlord agrees to this, requiring prior written notice to the landlord at least establishes a paper trail of who installed what and when and gives the parties the opportunity to discuss whether, at lease expiration, a particular installation may trigger an ownership controversy.

Though it may be too little, too late in some instances, a landlord and tenant walk-through of the premises before the tenant moves out affords the parties the opportunity to discuss their expectations and avoid last-minute surprises. It is more difficult to find common ground after the tenant moves out than before.

This short discussion omits other parties that can become engaged in ownership disputes, such as the landlord's lender and the tenant's lender, but the discussion hopefully offers a few practical measures that landlords and tenants, and their advisors, can take to minimize the risk of protracted, and expensive, disputes over who owns what at critical stages of the landlord-tenant relationship. □

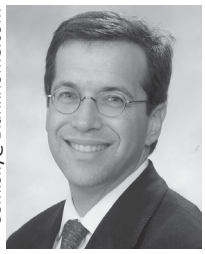
Chambers USA 2015 Honors Blank Rome Real Estate Practice and Attorneys

REAL ESTATE (PENNSYLVANIA)

Chambers 2015: Blank Rome's real estate group is known for its "diverse and deep bench of expertise with strength in complex portfolio and joint venture matters." The group "frequently acts on behalf of financial institutions in financing transactions and provides expertise in zoning and land use work."

Sources say: "They offer not just pure legal advice, but they also go beyond that and provide us real insights into the risks involved in a transaction. They have a great business sense." • "They are creative problem solvers and get deals done."

BLANK ROME REAL ESTATE GROUP RANKINGS IN *CHAMBERS USA*



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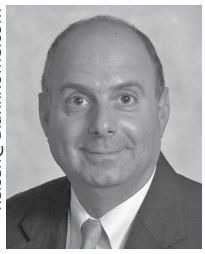
Matthew J. Comisky: Ranked in Pennsylvania, Real Estate.

***Chambers USA* states:** "Matthew Comisky is recognized for his real estate finance expertise, particularly in relation to traditional and non-traditional lending transactions. Sources describe him as 'very knowledgeable and a very reasonable negotiator.'"

Mr. Comisky is located in Blank Rome's Philadelphia office.



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***Chambers USA* states:** "Peter Kelsen frequently advises owners, financial institutions and developers in zoning and land use matters. He is held in particularly high regard, with commentators noting that 'he is the best zoning attorney in the city.'"

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***Chambers USA* states:** "The 'exceptional' Martin Luskin is a 'creative problem-solver who gets deals done,' clients say."

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***Chambers USA* states:** "Philip Rosenfeldt is deeply experienced in all manner of real estate transactions including development projects, acquisitions and leasing transactions. Interviewees praise his ability to 'stay focused on the important parts of the deal and achieve closure quickly.'"

Mr. Rosenfeldt is located in Blank Rome's Philadelphia office.

The quotes, commentary, and rankings referenced in this document are published in *Chambers USA 2015.*

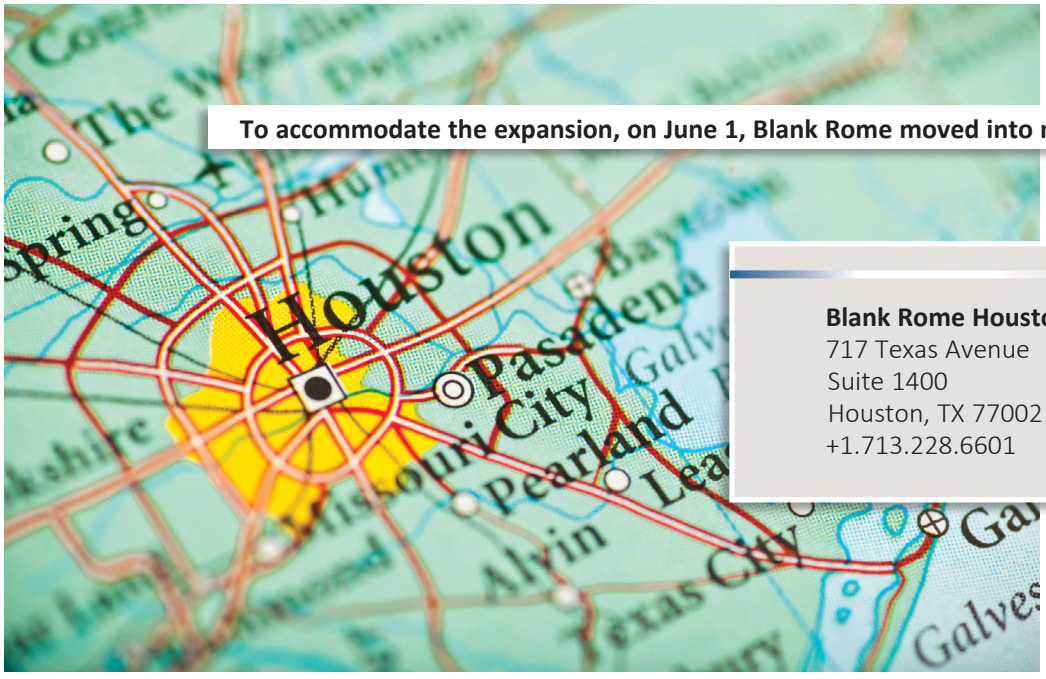
BLANK ROME LLP

ANNOUNCEMENT

Blank Rome Welcomes 23 Attorneys of Wong Cabello

Blank Rome LLP is pleased to announce that 23 attorneys and additional staff from the intellectual property law firm of Wong, Cabello, Lutsch, Rutherford & Brucculeri L.L.P ("Wong Cabello") have joined the Firm in its new downtown Houston office, on June 9. As a result of these additions, Blank Rome significantly bolsters its IP practice to more than 60 attorneys and broadens its service offering to clients. All five name partners have joined the Firm, with J. David Cabello serving as co-chair of Blank Rome's Intellectual Property and Technology group. They bring with them an additional 6 partners, 3 of counsel, 9 associates, and professional staff.

The Wong Cabello national IP practice aligns with Blank Rome's existing intellectual property practice, including litigation, patent prosecution, licensing, and trademarks. Wong Cabello has been lead counsel on more than 100 patent lawsuits in all key jurisdictions, conducted more than 35 *inter partes* review proceedings, and won numerous litigation matters across the country and the district courts of Texas. They represent clients in a number of technology areas, including computer science, electronics, manufacturing, semi-conductors, Internet technology, nanotechnology, petroleum services, chemical processing, fiber optic switches, financial services, telecommunications, communications, hospitality, consumer products, and biotechnology.



To accommodate the expansion, on June 1, Blank Rome moved into new office space at:

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BLANK ROME SPEAKING ENGAGEMENTS

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MARTIN LUSKIN
PARTNER

Blank Rome Real Estate Partner **Martin Luskin** spoke at the WeiserMazars Real Estate CFO Summit on "Power Panel: Joint Ventures & Equity Raising," which was held on May 14, 2015, at the Harold Pratt House & Peterson Hall in New York City. The panel discussed the following key topics:

- best practices for the CFO role within equity raising and deal making;
- balancing fund raising efforts and priorities between property, portfolio, fund, company, and line of business;
- working together with the CEO/Managing Partner, CIO, and capital raising team; and
- deal terms: managing risk and/or reward today.

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VINCENT LEON-GUERRERO
PARTNER

Blank Rome Real Estate Partner **Vincent Leon-Guerrero** was the featured panel speaker at the ABA's Estate Planning and Real Property Spring Symposia on "Negotiating Commercial Purchase and Sale Agreements: What's Market?", which was held on May 1, 2015, at the Capital Hilton in Washington, D.C. The panel examined commercial purchase and sale agreements with an emphasis on what is market for the key elements of such agreements, including:

- representations and warranties;
- casualty and condemnation;
- conditions, estoppels, adjustments, and indemnities; and
- techniques and strategies for negotiating specific clauses.

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WILLIAM S. SMALL
PARTNER

Blank Rome Real Estate Partner **William S. Small** moderated a panel at the USC Gould School of Law 2015 Real Estate Law and Business Forum on "Is Foreign Investment in U.S. Commercial Real Estate Here to Stay?," which was held on March 12, 2015, at The Jonathan Club in Los Angeles, CA. Blank Rome LLP was also a proud sponsor of this annual flagship event. The panel discussed the following key topics:

- significant sources of foreign capital, including EB-5 financings, sovereign funds, and direct private investment; and
- the impact that foreign capital is having in Los Angeles with projects such as Metropolis and Figueroa Central and acquisitions like the U.S. Bank Tower.

Underwater Cover: The Supreme Court's Protection of Junior Mortgage Holders

BY STEVEN A. SHOUMER

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PARTNER

On June 1, 2015, with a decision that is sure to please junior mortgage lien holders, the United States Supreme Court held in a Chapter 7 bankruptcy case known as *Bank of America, N.A. v. Caulkett* that a junior mortgage lien holder's mortgage would not be invalidated simply because the entire value of its mortgage is underwater. In *Caulkett,* the Supreme Court specifically examined whether 11 U.S.C. Section 506 of the United States Bankruptcy Code (the "Code") voids the lien of a second mortgage lien holder on a residential property because the value of the property was less than the amount of the first mortgage lien holder's lien and thus not a "secured claim."

Underwater Junior Mortgages

David Caulkett and Edelmiro Toledo-Cardono, the debtors in *Caulkett,* each had two mortgage liens encumbering their respective homes when they separately filed for Chapter 7 relief under the Code. The amount owed on each debtor's first lien mortgages exceeded the value of each debtor's home, therefore rendering the second lien mortgages completely underwater—essentially, the second lien mortgage holders would receive no money if the properties were sold today. Each debtor argued under their Chapter 7 bankruptcy cases that the second mortgage liens should be "stripped off"/voided because they were not allowed "secured claims" under Section 506(d) of the Code due to the fact that Section 506(a)(1) provides that an allowed claim secured by a lien on property is unsecured "to the extent that the value of such creditor's interest…is less than the amount of such allowed claim." The Bankruptcy Court agreed and the Eleventh Circuit affirmed the decisions to "strip off"/void the second lien mortgages in their entirety.

In *Caulkett,* however, the Supreme Court decided that the artificial distinction between a partially underwater mortgage lien (as in *Dewsnup*) and a completely underwater mortgage lien (as in *Caulkett*) does not hold water.

The Eleventh Circuit's decision to uphold the Bankruptcy Court's decisions was obviously not a welcome decision to many junior residential lenders across the country and the cases were appealed to the Supreme Court.

The *Dewsnup* Application

The Supreme Court had previously decided in *Dewsnup v. Timm,* 502 U.S. 410 (1992), that a mortgage lien that is only partially underwater would not be written down to

NOTEWORTHY REAL ESTATE DEALS

- Blank Rome LLP represented a client in a joint venture that closed the portfolio sale of **14 assisted living facilities** to a senior housing fund. The facilities were located in California, Texas, North Carolina, West Virginia, and Oklahoma. The aggregate purchase price was **$160.8 million.**
- Blank Rome LLP represented **Shinhan Bank New York Branch,** as administrative and collateral agent, on behalf of Shinhan Bank New York Branch, Woori Bank New York Agency, and Hana Bank New York Agency, in providing a commercial mortgage loan in the sum of $68.5 million to finance the purchase of a class-A office building in Washington, D.C.
- Blank Rome LLP represented **a national cycling company** in signing two leases for space in a brand new development in Culver City, California, in April. One lease covers a new studio that SoulCycle will open in a newly developed outdoor luxury shopping center, and the other is for SoulCycle's new West Coast office headquarters, to be located in the same mall. The studio will be used for SoulCycle's standard class offerings as well as for employee training. ◻

the value of the property as long as any value remained—in other words, so long as just one dollar of the remaining value of the real property is just one dollar greater than the amount of the mortgage lien in question, then the lien would remain as a valid secured claim. The decision, however, left open the interpretation that a *completely* underwater mortgage would be void. The Supreme Court's decision in *Dewsnup* has been embraced by debtors and their attorneys because it prevents an underwater junior mortgage holder from holding a potentially blocking position as a debtor attempts to negotiate a settlement in bankruptcy with a first lien mortgage holder.

The debtors in *Caulkett,* therefore, asserted that the holding in *Dewsnup* required the Supreme Court to uphold the decision of the Eleventh Circuit and void the second mortgage lien holders' mortgages.

The *Caulkett* Decision

In *Caulkett,* however, the Supreme Court decided that the artificial distinction between a partially underwater mortgage lien (as in *Dewsnup*) and a completely underwater mortgage lien (as in *Caulkett*) does not hold water. In particular, the Supreme Court noted that "[g]iven the constantly shifting value of real property, this reading could lead to arbitrary results" and potentially deprive a second lien mortgage from the benefit of any potential appreciation of the real property in the future. The Supreme Court elaborated that the *Dewsnup* decision provided that a "secured claim" under Section 506(d) of the Code "is a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim." The Supreme Court, therefore, reversed the decision of the Eleventh Circuit and held that the junior mortgage lien would not be "stripped off"/voided under Section 506(d) of the Code.

The *Caulkett* decision certainly provides greater clarity for junior residential mortgage lenders in the bankruptcy context. Although the *Caulkett* case centers on residential home mortgages, there are potential implications for commercial mortgage lenders as well. While it remains to be seen whether the *Caulkett* decision will be extended to the commercial context, junior lenders in both the residential and commercial context should take note. □

Environmental Litigation, Compliance, and Transactional Costs to Increase as a Result of EPA's New Vapor Intrusion Guidance

BY MARGARET ANNE HILL AND THOMAS M. DUNCAN


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On June 11, 2015, the U.S. Environmental Protection Agency ("EPA") released two technical guidance documents that address assessment and mitigation activities at residential and non-residential sites where vapor intrusion is an actual or potential concern, including sites being investigated under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") and the Resource Conservation and Recovery Act ("RCRA").

Vapor intrusion refers to the migration of vapors from contaminated subsurface sources, such as groundwater, through soil and into overlying building and structures. Vapor intrusion may be a potential concern at any building located near soil or groundwater contaminated with vapor-forming hazardous materials.

The EPA's focus on vapor intrusion has grown significantly over the last decade, as has the focus of state regulatory agencies involved in reviewing and directing remedial actions to address releases of hazardous materials.

The EPA's focus on vapor intrusion has grown significantly over the last decade, as has the focus of state regulatory agencies involved in reviewing and directing remedial actions to address releases of hazardous materials. The

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Environmental Litigation, Compliance, and Transactional Costs to Increase as a Result of EPA's New Vapor Intrusion Guidance (continued from page 12)

new guidance documents incorporate the EPA's current recommendations for identifying, evaluating, and managing vapor intrusion, while providing some flexible technical approaches to accommodate site-specific conditions and circumstances. These guidance documents were intended to promote national consistency in assessing and addressing the vapor intrusion human exposure pathway at contaminated sites. Indeed, many states have been awaiting the publication of these guidance documents before releasing their own state vapor intrusion guidance documents. The two new vapor intrusion guidance documents, which have not yet been published in the Federal Register, supersede and replace the EPA's 2002 Draft Vapor Intrusion Guidance.

The *Technical Guide for Assessing and Mitigating the Vapor Intrusion Pathway from Subsurface Vapor Sources to Indoor Air* applies to all sites being evaluated under federal remedial statutes. This guidance document addresses preliminary vapor intrusion assessments, sampling, risk assessments, exposure scenarios, mitigation, and subsurface remediation. The second guidance document, the *Technical Guide for Addressing Petroleum Vapor Intrusion at Leaking Underground Storage Tank Sites,* addresses sites where vapor intrusion related to petroleum contamination from underground storage tanks is a potential concern. Further, the EPA has a Vapor Intrusion Screening Level ("VISL") Calculator to assist in identifying applicable screening levels for a particular site.

At sites where vapor intrusion poses a potential or actual hazard to occupants' health or safety, exposures usually can be prevented or reduced through relatively simple actions, such as changing building pressure and ventilation. In most cases, costs associated with addressing vapor intrusion can be manageable, resulting in what the EPA believes to be long-term benefits, including improved public health and less costly response actions. The EPA believes that these benefits are especially likely when actions are undertaken early.

The new guidance documents, which the EPA will rely upon in connection with response and enforcement, will result in several impacts. First, the EPA's focus on vapor intrusion will likely increase remedial obligations under CERCLA and other statutes requiring remediation, such as RCRA. Second, due diligence costs associated with transactions that involve the sale, purchase, or leasing of real property are likely to increase as parties involved in those transactions determine that the risks associated with potential vapor intrusion issues warrant investigation and mitigation, which could even include sites where remedial actions have already been implemented and received a "no further action" status if those sites were not previously investigated with "vapor intrusion" as a pathway for exposure. Third, the additional inquiry into the potential for vapor intrusion as set forth in the new guidance documents may result in private party litigation serving to provide plaintiffs with another cause of action by which to claim exposure to vapors from hazardous materials and contaminants, and damages resulting from that exposure. In cases involving properties that have received remedial action approval without any focus on a vapor intrusion pathway, the ability to defend against such litigation may prove difficult.

The new guidance documents and supporting tools can be found by clicking on the following:

- Technical Guide for Assessing and Mitigating the Vapor Intrusion Pathway from Subsurface Vapor Sources to Indoor Air (June 2015)
- Technical Guide for Addressing Petroleum Vapor Intrusion at Leaking Underground Storage Tank Sites (June 2015)
- Vapor Intrusion Screening Level ("VISL") Calculator
- VISL User Guide

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