Real estate
is our domain℠
GlobeSt.com™

Critical Issues: The ISRA Mouse that Roared

By Edward J. Hunter
and Steven L. Humphreys
May 12, 2008


Hunter

A letter from a state regulatory agency confirming that a certain statute does not apply to a particular real estate or corporate transaction may seem like a minor bureaucratic event. But when it comes to transactions involving commercial or industrial property in New Jersey, the Department of Environmental Protection's (NJDEP) now-discontinued practice of issuing Letters of Non-Applicability (LNAs) under the state's Industrial Site Recovery Act, N.J.S.A. § 13:1K-6 et seq. (ISRA) is anything but.

While not technically required under ISRA, LNAs have come to be a familiar and much relied-on punch list item in most transactions involving commercial and industrial real estate in New Jersey. Purchasers, landlords and lenders have come to rely heavily on them as a way of obtaining assurances, backed by the NJDEP's official imprimatur and the certification of LNA applicants (made under penalty of perjury), that a given purchase transaction or tenant's cessation of operations will not trigger ISRA's requirements.

But with the NJDEP's recent announcement that as of May 1, 2008, it will no longer issue LNAs as it seeks to cut costs in the midst of a statewide budget crisis, parties to thousands of transactions across the state are scrambling to find acceptable substitutes for the heretofore ubiquitous LNA. The NJDEP announced it was taking the action because LNAs are not required under ISRA for transactions that do not trigger the requirements of the statute, and the Department prefers instead to focus its scarce financial resources on programs that involve mandatory compliance obligations.

Unfortunately, that will come as little consolation to parties seeking to confirm that their transaction will not trigger the statute's requirements, which can be onerous. (ISRA requires parties who transfer ownership or cease operations -- including vacating tenants -- at qualifying "industrial establishments" to perform environmental investigations of real property associated with the establishment and, if necessary, to remediate them.)

Without the availability of LNAs, parties to transactions that potentially may trigger ISRA will now have to rely on their own environmental consultants and legal counsel to advise them as to the applicability of ISRA to a given transaction. Consequently, greater vigilance will be required on the part of purchasers, landlords and lenders in performing environmental due diligence and in negotiating appropriate contractual protections, since these now will be the only avenues available to ensure that ISRA is fully complied with and/or does not apply.

While the obligation to comply with ISRA rests with the seller, purchasers who do not take adequate steps to confirm that the statute is not applicable potentially could find themselves either becoming directly liable for environmental contamination pursuant to other statutes like the New Jersey Spill Compensation and Control Act or, as a practical matter, unable to sell the property without performing remediation. Additionally, in lease transactions, since the obligation to comply with ISRA rests jointly with tenants and landlords, ensuring proper compliance with ISRA when triggered is an imperative for both owners of property and the ultimate end user.

In most cases, it will not be sufficient to rely on a simple representation by the seller or tenant that a purchase transaction or cessation of operations will not be subject to ISRA, as the purchaser or landlord will have no way of satisfying itself that the seller or tenant performed the proper analysis to make this determination. In the case of sales transactions involving commercial or industrial property, where the seller is often a single-purpose limited liability company that existed only for the purpose of holding the property, the breach of such a representation may be of little value to a purchaser if the entity ceases to exist after the transaction is completed.


Humphreys

It is also of little comfort that the seller may be subject to enforcement action by the NJDEP for failure to comply with ISRA, since the NJDEP's enforcement of the violation may fall prey to overriding enforcement priorities. Likewise, a tenant's lease obligation to comply with ISRA may be of little value if a landlord relies on a tenant's simple representation that its cessation of operations will not trigger ISRA, if it is determined years down the road that ISRA was in fact triggered. In such a case, if the tenant is no longer a viable entity, cannot afford to perform the required investigation/remediation work, or is not susceptible to service of process, the landlord could be the party left "holding the bag" for the ISRA obligation as a jointly and severally liable party.

Making a determination that ISRA does not apply to a given transaction or cessation of operations can be a complicated process, as it requires the person making the determination to sift through information about a property's history of operations in order to determine whether they fall within ISRA's intricate definition of an "industrial establishment." So, what's a purchaser or lender to do?

For one thing, purchasers of commercial or industrial real estate in New Jersey having any potential for contamination from past operations should work closely with legal counsel and environmental consultants to conduct rigorous due diligence into the history of operations conducted at properties being purchased. Lenders who take a mortgage interest in commercial or industrial properties or in leaseholds involving such property, as well as landlords intending to lease out commercial or industrial space, should do the same.

Based on a careful review of the relevant circumstances, legal counsel can then advise purchasers and lenders as to whether a particular transaction will trigger ISRA. In addition, legal counsel with an understanding of and experience with ISRA should be engaged to negotiate appropriate contractual protections with sellers', tenants' and borrowers' counsel, such as representations and warranties, which will help smoke out information pertinent to the ISRA applicability determination process. In this way, landlords, purchasers and lenders should be able to achieve an equivalent level of assurance of ISRA non-applicability as an LNA.

The views expressed here are those of the authors and not of Real Estate Media or its publications.

Edward J. Hunter is a partner and Steven L. Humphreys is special counsel in the Parsippany, New Jersey office of Kelley Drye & Warren LLP. They can be reached at ehunter@kelleydrye.com and shumphreys@kelleydrye.com.