Reprinted from the issue of February 11th, 2008

BANKER & TRADESMAN

THE REAL ESTATE, BANKING AND COMMERCIAL WEEKLY FOR MASSACHUSETTS *ESTABLISHED 1872*

LAW OF THE LAND

Imposing Activity and Use Limitations May Offer an Escape Hatch for Tenants

By Ronald W. Ruth and Ani E. Ajemian

HARD TIMES MAKE FOR INTERESTING LEGAL cases. In a declining economy, tenants often review their leases with great care to identify potential escape hatches. As a result of a recent Massachusetts Superior Court case, tenants seeking a way out of their leases may have a new means of attack. In *Cummings v. Mass General Physician's Organization*, the Superior Court determined that the existence of an Activity and Use Limitation, which had not been properly disclosed to the tenant, allowed the tenant to rescind its lease.

A bit of background on the increasingly powerful AUL: During the 1990s the Massachusetts Department of Environmental Protection adopted a risk-based approach to the cleanup of oil and other hazardous materials. The concept was to tailor remediation of oil and other hazardous materials to eliminate the risks associated with their presence, but no more. However, it soon became apparent with industrial and commercial properties that it was redundant to perform remediation to eliminate risks linked to certain property uses (such as day-care centers or agricultural operations) when those uses were irrelevant to the property in question. As a result, the concept of the AUL arose. With an AUL, the likelihood of human exposure to contaminants could still be mitigated by limiting the designated use of the contaminated property. With an AUL in place, the government could be assured that the risks associated with contamination were being managed, without imposing the burden of unnecessary remediation on the interest-holder.

In Cummings, the Superior Court stated in broad terms that imposing an AUL can affect a tenant's interest in a lease, and that notice of its existence is crucial to its decision to enter the leasehold. In particular, the court noted "the AUL restricted the pool of potential sub-lessees or assignees of the lease," and that a lessee "might determine that operating on a less-than-fully remediated brownfields site was incompatible with its clinical mission, or could be otherwise 'bad for business'." Overall, the court stated that, "taken as a whole, the stated goals and purposes of … AULs bespeak a policy whereby lessees and others who would acquire interests in contaminated property are made aware of associated risks, and make their decision armed with all the information they are due."

As a result, Cummings presents two questions for potential and existing leaseholds to consider: can failure to properly notify a tenant of an AUL mean it can get out of its lease?; and does a landlord expose itself to a potential default under a lease by imposing an AUL after the implementation of a lease, and arguably encumbering the property beyond its representations in the lease?

While the Superior Court may have answered the first question in Cummings, the second is a curious proposition for landlords to consider. The discussion begins with the basic tenet in real estate law that encumbrances recorded subsequent in time to a tenant's leasehold interest (conventionally reflected by its recorded Notice of Lease) do not affect the tenant. This principle gives rise to the common practice of subordination and non-disturbance agreements, recognition agreements and the like. For example, a lender typically desires to establish its interest as superior to that of preceding leasehold interests, notwithstanding that it is recorded later in time. Thus, in a subordination, the previously filed Notice of Lease is subordinated to the later filed financing or mortgage interest.

Statutes and regulations require AULs be recorded, for notice be provided to all persons with an identified interest in the property, and the opportunity for a 45-day comment period between landlord and tenant, but there is no requirement for holders of prior property interests to subordinate to the AUL. Though troublesome, this approach accomplished the DEP's objectives. Frankly, side stepping the more cumbersome approach of subordination was made possible through the significant enforcement powers held by the state under environmental statutes.

For example, violations of Chapter 21E can be prosecuted both criminally and civilly, with monetary penalties of $25,000 a day established by statute. Further, the regulations related to AULs impose a duty on all persons with notice to abide by its terms. With its notice requirements in place, the DEP and the commonwealth could be confident that both existing and subsequent tenants, and the like, were aware and would honor the limitations on

Continued on Next Page

RONALD W. RUTH *is chairman of Boston-based law firm Sherin and Lodgen's (www.sherin.com) real estate department and co-chairman of the firm's environmental law group.* ANI E. AJEMIAN *is an associate at the firm. She specializes in environmental, real estate and land-use law.*

Continued from Previous Page
use imposed by the AUL, without the need for subordination.

Many leases expressly provide for a representation by a landlord that title to the property is encumbered only by identified, so-called "permitted" encumbrances. The thinking behind such a clause is that the tenant is made aware of any encumbrances prior to entering the lease, and that any encumbrances imposed subsequent to its Notice of Lease would not affect its interest. The advent of the AUL, coupled with the related enforcement powers of the DEP, undercut this assumption. If a tenant were to violate the terms of the AUL, it too becomes vulnerable to enforcement by the state. A tenant in this position may then turn to the landlord for imposing unanticipated restrictions on the lease.

The implementation of the AUL accomplished the DEP's overall objective, but left unresolved the effect it would have when imposed by a landlord on a pre-existing tenant's interest. Often in commercial leases, use clauses allow for any lawful use. Furthermore, conventional real estate law does not permit landlords to unilaterally impose amendments to a lease. The imposition by a landlord of an AUL subsequent to having entered into a lease with a tenant, with a general use clause, arguably reduces the tenant's rights under the lease. Even if a tenant was not directly affected by the reduced available uses, the loss of potential uses, either for a change of its own operations or in the case of an assignment or sublet, is not without significance.

How Cummings will be applied where a tenant's Notice of Lease pre-dates an AUL or Environmental Deed Restriction is yet to be determined. However, relying on the broad language of the court, a tenant faced with the imposition of an AUL may wonder whether it, like the tenant in Cummings, is able to challenge on-going validity of the lease. Presumably, a tenant taking this position would have a stronger case if it had objected in writing to the imposition of the AUL during the relevant 45 day period, but whether such an objection is required is yet to be determined.

As tenants will inevitably revisit their leases with a careful eye during difficult economic times, the language of their particular lease and result of an AUL imposed on the property just may present a potential escape hatch. ■