~~DRAFT 24 August 2014~~

FALCO LEGAL TRAINING

Minimum Energy Efficiency Standard Regulations

This is a response to the Minimum Energy Efficiency Standard (MEES) Regulations consultation from Peter Williams of Falco Legal Training Limited.

About me

I have been a commercial property lawyer for over 30 years. Until 1994 I worked as a lawyer (~~and then~~or, for some of the time, as a partner) in law firms in the City of London. For approximately the past 20 years I have ~~taught~~advised on property law and landlord and tenant law within law firms as a Professional Support Lawyer or, in the last year, as an independent consultant. This has involved teaching and acting as internal counsel among other responsibilities.

I was a member of the Non-Domestic Minimum Building Energy Performance Standards Working Group (the "Working Group"). This does not necessarily mean that I agree personally with all of the Working Group's recommendations contained in the Report to Government.

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Initial comment about the length of the consultation period

As you are already aware, I believe that the six-week period for consultation has been insufficient, particularly as it fell exactly over the school holiday period. Few committees and groups meet during that period, so you will be receiving fewer, and less considered, responses to the consultation than would have been the case had you consulted for a longer period.

The difficulties tend to emerge from the detail in this type of legislation, so I am also concerned that the draft regulations are being made available only to a select set of lawyers (of whom I am one). Having studied the draft regulations, I believe they would benefit from being the subject of a wider consultation, once the principles of MEES have been established through the current consultation.

The spring 2015 deadline for making the regulations is no doubt well-intended, but it is an entirely arbitrary deadline. This policy is too important for the process to be rushed through merely to ensure that the regulations are in place before the 2015 general election. If it turns out that further time is needed, it should be provided. I fear that it will otherwise be a case of more haste, less speed.

RESPONSES TO THE CONSULTATION QUESTIONS

1. Do you agree with the proposed scope of buildings and leases that should be covered by the minimum standard regulations? If not, what building or lease types should be included or excluded?

I have the following observations.

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Listed buildings

It is stated in para 43 that the scope of buildings within MEES will be those within the EPC requirements. This will cause difficulties for listed buildings as no-one knows whether they require EPCs or not. The exemption for listed buildings in the EPC regulations has been incorrectly drafted and it does not make sense. It is therefore not possible to say with any certainty whether or not an EPC is needed for listed buildings. The EPC regulations need to be amended to make this clear.

Very short leases and long leases

The Government suggests in para 45 excluding very short leases (six months or less) and very long leases (99 years or more).

It is important that when the regulations are drafted, they provide that a lease of exactly six months is excluded.

Where more than one such lease is being granted consecutively to the same tenant, there needs to be some maximum length to prevent abuse of this exclusion. However, limiting the number of leases to two is very restrictive. It would be more sensible to limit the total length of the lettings to 12 months (however many leases are granted). This is the solution adopted by section 43(3) Landlord and Tenant Act 1954, which provides an exclusion from commercial security of tenure for short leases in very similar circumstances.

Similarly a lease of exactly 99 years should be excluded.

It is the length of the original term of the lease that is granted that is relevant, not the length of the residue of the term at any particular point. The reason for excluding these long leases is that they are effectively sales not lettings.

Leases that the landlord has ~~t~~no choice whether to grant

My view is that MEES should not apply where the landlord has no choice but to grant a lease. This occurs in various different circumstances as follows:

Existing contractual arrangements as at the date when the regulations are made. If the landlord has already agreed before the date when the regulations are made to grant a lease, this should not be caught. There will probably be very few such agreements but in case there are any, they should be excluded.

Lease granted to a guarantor following insolvency of the tenant. This is effectively the guarantor taking on the tenant's obligations under the lease, except that as a result of the insolvency the landlord has to grant a new lease to the guarantor. However, it is still essentially the same letting and should not trigger MEES.

Lease granted under section 19 Landlord and Tenant (Covenants) Act 1995. The landlord has no choice whether to grant the lease, if the former tenant asks for a lease to be granted to it under this statute.

Lease granted by order of the court. Again the landlord has no choice whether to grant the lease.

Lease granted by operation of law. Again the landlord has no choice whether to grant the lease. The lease comes into being regardless of the parties' intentions.

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Lease renewal under Landlord and Tenant Act 1954 or the extension of a lease (see question 8 below) ·

Renewal of periodic tenancy. In a periodic tenancy (eg a monthly tenancy), the legal effect is that a new lease is granted automatically at the end of every period. If periodic tenancies were not excluded, this would mean that the landlord would technically be in breach of MEES on the first automatic renewal of the tenancy after 1 April 2018.

Sub-lettings of parts of buildings

I have a major concern about the effect of MEES where a sub-lease is being granted in respect of only part of a building. If a tenant of part of a building wishes to grant a sub-lease, there is no doubt that MEES will apply to the transaction. But the tenant may not have control of the parts of the building that will enable him to comply with MEES.

For example, the tenant of the fourth floor of a building may wish to grant a sub-lease of the whole of the fourth floor (if it no longer needs it) or just part of it (if it has some surplus space). Its own lease of the fourth floor premises will not include any part of the structure of the building, or any part of the plant and machinery within the building. So the tenant is no position to improve, for example, the windows of the building, or the plant and machinery (including the heating and air conditioning equipment) – and nor would the landlord want the tenant to try to upgrade the structure of the landlord's building, or its plant.

This important issue is mentioned in the consultation document (para 47) but only in terms of "consent". I am not convinced that this is sufficient. It is not correct that a tenant of part would need the landlord's "consent" to upgrade the building's structure or air conditioning system. The correct analysis is that the tenant has no right to do so at all.

My suggested solution is that where a sub-lease is being granted of only part of a building, the obligations of the tenant (as landlord of the sub-lease) **should apply only to the parts of the building that are within the tenant's own lease**. There should be no obligation on the tenant (as landlord) to carry out any works in any other part of the building.

2. Do you agree that where a property falls below an E EPC rating, the landlord would only be required to make those improvements which could be made at no net or upfront cost, for example through a Green Deal finance arrangement? For those properties that do not meet an E EPC rating, do you have any suggestions for how the process could be streamlined?

This proposal sets out what the Government has always said would be the case. I cannot envisage the regulations requiring anything different.

There is a suggestion in para 58 that the landlord would need to obtain three Green Deal quotes where no measures at all pass the Golden Rule. This seems unreasonable. First of all, it suggests that the Government does not have much confidence in the accuracy of Green Deal Assessments. Secondly, on each occasion the landlord would have to pay for this. The document suggests that there would be no charge for these quotes, but this is most unlikely to be the case for commercial properties. Thirdly, once green deal assessors understand that in every case they are unlikely to get work from this sort of exercise, they will refuse to carry out such assessments and in practice landlords will find it impossible to obtain three separate quotations.

3. Should the Government allow landlords the option of demonstrating compliance by installing those measures which fall within a maximum payback period, and if so do you have any evidence on an appropriate payback period? Do you have any views on how the process of identifying improvement payback periods should operate?

~~[Can anyone assist me to assist the Government by providing an answer to this question?]~~
I cannot assist here.

4. Do you agree with the proposed method for demonstrating an exemption where works would result in a material net decrease in a property's value? What would be the most appropriate way to set the threshold?

The greatest concern here is the installation of measures such as internal wall insulation that could reduce the net lettable area.

I think a simple percentage reduction would be the only safe way to demonstrate a material net decrease in a property's value. This has the advantage that the same formula would be relevant for all types of property, and for all parts of England and Wales. The landlord has to know that the exemption has been assessed by an objective method and cannot be challenged later by a Trading Standards Officer.

Setting the threshold is effectively plucking a number out of the air. I think the basis of the calculation should be the same across the whole of England and Wales, which means that a percentage figure is going to be required.

The consultation document suggests ~~XXX~~5% or 10% but this seems very high. I think a figure in the order of 2% would be more suitable. For a building worth £1m, that would equate to £20,000 which is a significant figure.

5. Do you have any evidence that shows the scale of the costs and benefits (including non-financial costs and benefits) associated with improving the energy efficiency of a property, for example time taken to undertake cost effective improvements?

I am not able to comment on this.

6. Does the proposed consents exemption strike the right balance between recognising existing landlord obligations, whilst also ensuring that the allowance is not used as a loophole to avoid undertaking improvements? Do you have any views on how beneficial owner consents should be taken into account?

Paragraphs 76 and 77 raise some difficult issues as to the implications of "unreasonable" conditions attached to consents. I do not understand the second sentence of para 76, which reads "In this case, where the conditions are unreasonable, the landlord would not be expected to proceed." The difficulty is that an "unreasonable" condition has two possible meanings – that it is unreasonable for the person to make it in the first place or that it is unreasonable for the other party to have to comply with it.

For example, consider a condition imposed by a supermarket tenant that, in order to fit in with its business requirements, any works can be carried out by the landlord only between midnight and 4.00 am. Is that an unreasonable condition, in either of those senses? The regulations need to make this clear. (I believe that in that case it would be reasonable for the supermarket tenant to impose such a condition, and reasonable for the landlord not to have to undertake works to comply with that condition.)

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7. Do you think the regulations should have a phased introduction applying only to new leases to new tenants from 1 April 2018? Do you agree the regulations should also have a backstop, applying to all leases from 1 April 2023? If not, what alternatives do you suggest?

As a member of the Working Group, I have always argued for a soft start as it seems unreasonable to require a landlord to revisit an agreement it has already entered into with a tenant (as would be the case with a hard start). Therefore I am pleased to see that the Government favours this option.

However, a backstop has been proposed. This would require all landlords at least to talk to their tenants where leases are already in place now and will run beyond 2023. Presumably the tenant would still be able to refuse consent to the landlord to carry out the works on the basis that the lease does not reserve to the landlord any right to enter the premises for such purposes. Once again we need to ensure that the definition of "consent" is sufficiently wide to cover this possibility.

Personally, I believe that there should not be a backstop date. This is for three reasons.

(a) I have no evidence but my feeling is that by approximately 2030 virtually all (say 95%) existing leases of commercial property in existence in 2018 will have expired. Therefore in order to find a new tenant, the landlord will either need to carry out energy efficiency works or demolish the building and re-build it. No backstop date is therefore necessary.

(b) The backstop will not apply where there is no EPC in place for the building. There is no requirement in the Energy Act 2011 for landlords to obtain an EPC where one does not already exist. So in such a case a landlord might benefit from not having obtained an EPC at that stage. That is counter-intuitive but apparently is the effect of the legislation. So having a backstop will –

- act as a disincentive for landlords to obtain "voluntary" EPCs with immediate effect;
- penalise landlords who happen to have obtained EPCs, including those who (in good faith) obtained voluntary EPCs – a most perverse decision; and
- benefit landlords who have granted leases since 2007 without obtaining EPCs when they ought to have obtained them. Rumour has it that there are large numbers of such leases (by definition it is impossible to know how many)

(c) Obtaining consents from tenants is likely to be costly and time-consuming, and (in my view, as explained in my response to question 14) will rarely result in the tenant giving consent. I do not know what the final regulations will say on this point, but I imagine that the landlord will have to draw up detailed and costed proposals *before* the tenant's consent can be sought. If the tenant then says "no", as I believe will almost inevitably be the case, all that effort and cost will have been wasted.

If there has to be a backstop date, then I believe that it should be later than 2023. I suggest that it should be 2030. The existing date of 2023 assumes that all leases are the average length. Many leases are longer than that and will not have expired by 2023 – but I think that most are likely to have expired by 2030.

8. Should the regulations apply upon lease renewals or extensions where a valid EPC exists for the property?

DECC and I clearly are ~~thinking differently in~~looking at this ~~area~~from different viewpoints.

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DECC believes it is best for the landlord to request permission from the tenant to carry out the works, and for the tenant to refuse if it does not want disruption to its business (or for any other reason). That would constitute an exemption for the landlord (subject to the "unreasonable conditions" point mentioned above).

I feel that this is against the spirit of MEES. The spirit is that the landlord does not have to upgrade an inefficient building, but if it wishes to let it then it must bring it up to an E rating. The alternative is an empty building (or the landlord can occupy it itself). But in a lease renewal (within the 1954 Act at least) the landlord has no choice about granting a new lease, and therefore should not be required to comply with MEES at all. Even where the lease does not have the protection of the 1954 Act, it is still economically sensible for the parties to renew the lease if they both wish to.

So **my view is that lease renewals should not be within MEES at all**.

The consultation paper states that no EPC is required for a lease renewal and so this would only apply where an EPC was already in place. It would be extremely unfair to prejudice those landlords who happened to have an EPC for their building that in such case a lease renewal would be subject to MEES, whereas landlords where there is no EPC (even where one should have been obtained) will not be subject to MEES on a lease renewal.

Incidentally I do not agree that no EPC is required for a lease renewal. This is stated in the DCLG Guidance Document but I believe this was a deliberate misunderstanding of the regulations at the time when the guidance was first issued. There is no exemption for lease renewals in the underlying EU Directive or in the EPC regulations. A lease renewal takes effect by the grant of a new lease, and in my view an EPC is required.

9. Do you agree that an exemption for properties below an E rating should last for five years, or where the exemption was due to a tenant's refusal to consent, when that tenant leaves, if before five years?

I agree that this is sensible.

The regulations need to make clear whether "a tenant leaving" means an individual tenant leaving or the lease coming to an end. This is not necessarily the same thing, as the tenant could leave as a result of the tenant selling the lease to a new tenant (the technical term is "assigning" the lease).

10. Do you agree that the Government should set a trajectory of standards beyond 2018, and if so, how and when should this be done?

Personally, I consider that it will be difficult enough to enforce a policy that requires a minimum of an E rating. To announce in a few years' time that landlords must repeat the process so that they now need to have (say) a D rating would not be well received.

So if there is an intention to improve the energy efficiency of buildings over time, it would be best to make this clear at the outset and include it in the regulations at the outset. There could otherwise be a great deal of ill-feeling later.

It would also mean that landlords might consider it worth carrying out more extensive (and expensive) works at this stage, if they knew that the ultimate aim is a D rating rather than an E rating.

However, there would need to be exemptions from the need to improve the energy efficiency on a change from E to D (say), in the same way as exemptions are needed for the backstop date.

11. Do you consider where a property has a valid exemption for letting below an E EPC rating that certification of compliance would be helpful? If so should this be voluntary or mandatory? Do you have any other comments regarding compliance and how Trading Standard Officers (TSOs) could be supported with enforcement, for example identifying landlords?

The concept of a certificate of compliance is something that was not considered by the Working Group and so it is a new issue to me.

There are no sanctions on a tenant who takes a lease of a property that is not compliant with MEES and it seems to me that the types of tenant that are likely to occupy F and G rated properties are (in the main) not likely to be interested in whether or not the landlord has complied with MEES.

I think the main beneficiaries of a certificate regime would be TSOs and future owners of the building, so that they know that the original exemption was permitted.

However, who would pay the cost? It would be inappropriate to require landlords to pay for a compliance certificate when the entire basis of MEES is that there is no upfront cost to the landlord. It would be particularly egregious to charge the landlord for a certificate to say that he is exempt from complying with MEES.

And if a mandatory certification process was put in place, there would need to be an appeal process to cover those occasions when a landlord believed he was exempt but the TSO refused to grant an exemption certificate.

It would not be possible for the granting of a certificate to be delegated to a third party organisation, because it is a decision against which an appeal must be able to be made.

All in all, my current view is that the concept of a certificate of compliance is helpful but the complexities are such that it is unlikely to be practicable.

12. Do you agree that the penalty for non-compliance should be linked to a percentage of a property's rateable value? If so, what percentage should this be? If not, what alternatives do you suggest? Should the Government set a minimum and maximum fine level, and if so at what levels should these be set?

The decision as to the size of penalty is a political one.

~~As~~The suggestion that a landlord should pay a penalty of the entire rent during the period of non-compliance is draconian. Many properties are financed by secured loans and the rent is used to repay the mortgage. Paying a penalty of the entire rent would mean that the landlord would be unable to repay the loan, and might lose the house.

It is important that you do not assume that landlords will only be in breach if they deliberately flout the rules. One cannot assume that landlords will know for sure whether, for example, one of the exemptions will apply. There is room for a difference of opinion in relation to, for example, whether a tenant has refused consent subject to unreasonable conditions. Landlords could end up inadvertently breaching the rules.

However, you need to be aware that, as this is only a civil offence, landlords are likely to compare very carefully the size of any possible penalty with the costs of complying with MEES. This will particularly be the case if there is a maximum penalty.

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Landlords are also likely to take into account the fact that there have been very few publicised sanctions under the EPC regulations, and conclude that this is likely to be the same with MEES.

13. Do you consider that the First-tier Tribunal is the appropriate body to hear and determine appeals about decisions regarding non-compliance with the minimum standard regulations? Do you consider that the General Regulatory Chamber Rules of the First-tier Tribunal will suit the handling of these appeals? If not, what tribunal could be used?

This is outside my area of expertise.

14. Do you have any comments not raised under any of the above questions?

I have a number of concerns.

Changes in EPC ratings

We have been told that the changes in building regulations mean that EPC ratings become more strict over time – so that a building with an E rating today might have only an F rating in a few years' time.

We are concerned that this could put a landlord in breach of MEPS. Were a re-rating to happen in, say, 2021, the landlord could grant a lease today (2014) when the building had an E rating. However by the time of the backstop in 2023, the building might be treated as having only an F rating and therefore the landlord would have to take some action under MEES. The regulations need to be drafted on the basis that the landlord can rely upon an EPC certificate that was valid at the time of the grant of a lease, and that any subsequent change in the rating system is not relevant.

Loophole of landlords not obtaining an EPC

MEES will not be relevant to a property where there is no EPC in place, since section 49(1) Energy Act 2011 states that MEES applies only where a property has an EPC.

For the proposed "backstop" in 2023, we can expect many properties that would be caught by it not to have EPCs, as many leases will have been granted before EPCs became compulsory in 2007 or thereabouts. But if a landlord deliberately did not obtain an EPC when granting a lease since 2007, MEES will also not apply, and the landlord's only offence is not to have obtained an EPC, for which the penalty is relatively low. It is likely to be much "cheaper" for a landlord to commit the "offence" of not obtaining an EPC than it would be to carry out energy-improvement works (and in the event that the landlord is not "caught", it will be cheaper still).

The working group identified this loophole. We do not know if DECC is planning to do anything to resolve it. I suspect it would need a change to the wording of the Energy Act 2011, which is unlikely to happen.

EPCs for new buildings

There will be EPCs of new buildings where the rating will be below E because of the rule that a minimum fit-out standard has to be used for producing an EPC – even though the final rating is bound to be higher. This rule results in buildings receiving incorrect EPC ratings and needs to be re-examined well before 2018.

Successor landlords

The regulations need to make it clear that anyone who buys a property from a landlord will be protected by an exemption enjoyed by that landlord.

For example, if L1 asks a tenant for consent to carry out works and the tenant refuses, L1 is not required to do anything further for five years (unless the tenant changes). If L1 then sells the building to L2 (subject to the tenant's lease), L2 must also be in the same position as L1 was. L2 must be confident that it does not need to take any further action for the remainder of that five year period (unless the tenant changes).

Obtaining consents from tenants

I have heard a suggestion that landlords should have to use "best endeavours" to obtain consent from tenants. This is too onerous (since it could require the landlord to pay money to the tenant in order to obtain its consent). I believe that "reasonable endeavours" should be sufficient.

It is important that DECC understands why I believe that tenants are may say "no" when asked to consent to energy-efficiency improvements (and therefore why it is preferable for the landlord to carry out works in a void period between leases).

First, there will be disruption to the tenant's business. This could be significant, depending on what works are being undertaken. In the case of a shop, for example, it might involving closing the shop at a time when it is usually open.

Secondly, it is likely that works will involve the tenant in some additional expense that would not otherwise be incurred – such as the cost of redecoration, or the cost of paying staff to be on hand at a weekend. In the case of a shop, this might include lost sales.

Thirdly, when the landlord lets premises to a tenant, everything in the premises (including the landlord's plant) now "belongs" to the tenant for the period of the lease, and it becomes the tenant's responsibility to look after/repair it. So it is may not be in the tenant's interest to allow the landlord to replace eg the boiler or the air conditioning chiller, as the tenant will assume an immediate responsibility for looking after it, and ensure that it integrates efficiently with the rest of the plant in the premises.

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Tenants carrying out works

The Working Group discussed the possibility of tenants being permitted to install energy efficiency improvements during the tenant's fit-out works. This would make sense since we do not want landlords installing improvements that are then ripped out by the tenants in order to accommodate their fitting-out works. This could be of particular concern in relation to shopping centres, since retail tenants have standard fit-outs laid down by their brand consultants. There is no mention of such an arrangement in the consultation document.

In such a case, the works would be carried out after the parties have exchanged agreements for lease but before the grant of the lease. The regulations need to make it clear that such an arrangement is permissible.

15. Do you have any comments or evidence regarding the consultation impact assessment that could inform the final impact assessment, for example the average length of void periods or length of tenant stay in different sectors?

~~[To be completed]~~I have included some comments in the Appendix

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Appendix – Comments on the impact assessment

Page 13 – FN 26. This says "Lease lengths have been used as a proxy for tenancy length, as there is no data on the length of tenancy." This is very mysterious as "lease" and "tenancy" are effectively the same thing. Obviously the writer believes they are different – but in what way ?

Page 22, para 35. I do not believe that Green Deal Assessments will be free in relation to non-domestic properties. They will take too long to undertake to be offered free.

Page 25, para 51. Para (i) uses the term "an unreasonable amount of time". That is a subjective statement. What you think is an unreasonable time may not be what I think is an unreasonable time.

Page 30, para 73. There is no comparison between the current proposals and the CRC Energy Efficiency Scheme. They apply to different sets of organisations and have entirely different policy aims. Any conclusions from the Element Energy survey mentioned in FN 57 are likely to be entirely irrelevant to the current proposals.

Page 32, para 76. You say that installation costs are expected to be the largest individual cost of the regulations. This may be incorrect. Loss of rent during void periods while the measures are being installed may well be the largest individual cost.

Page 32, para 80. It is not possible to say what the cost of a Green Deal Assessment will be in the non-domestic sector, since there is no non-domestic Green Deal system yet.

Page 33, para 82. If "hidden costs" include loss of rent during void periods while the measures are being installed, allowing 10% of the installation cost is likely to be a massive underestimate in the non-domestic sphere. FN 66 states that "for major works, void periods may have to be extended to complete the works, *though this is only expected to be the case in a small number of instances*." (emphasis added) Where is the evidence for the wording in italics ?

Page 72, para 252. It is unrealistic to say that it will take commercial landlords two hours to understand the regulations. It is likely to take at least that long to read the guidance. Where a landlord needs to make use of a temporary exemption then it will take much longer to understand the law, and it will almost certainly be necessary to obtain legal advice on the implications of the regulations. No figure has been included for the cost of obtaining legal advice. In addition, many landlords own properties that are let to more than one tenant and it may be necessary to consider different aspects of the regulations on different occasions in relation to just one building.

Page 75, para 273. I have been reliably informed (but without evidence) that it is generally believed that there has not been not full compliance with the EPC legislation, particularly in its early years.

Page 90, para 337. There is an omission here. If it is necessary to obtain a certificate of exemption before granting a lease where the EPC rating is below E, there will also be appeals from a refusal to grant such a certificate. There could be hundreds or even thousands of such appeals annually.

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