MEES:

How do you control – and overcome – the difficulties with MEES/EPC in commercial tenancies?

Who carries out the work, pays for it, and is liable?

How might minimum standards evolve?

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Introduction

The Minimum Energy Efficiency Standards ("MEES") impact commercial leases at every stage of their existence – and afterwards too.

MEES are not something to be ticked off for compliance at just one stage of the life of a lease. They impact the creation of a lease; they govern rent reviews and alterations during the lifetime of the lease; they affect the terms of any lease renewal; and they will have a profound effect on the extent of any remedial works once the lease has come to an end. And these changes are not imminent: they have already arrived.

The MEES in summary

The MEES are set out in the Energy Performance of Buildings (England and Wales) Regulations 2012 (SI 3118) and the Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 (SI 692), which were introduced pursuant to the Energy Act 2011. Although the MEES also apply to residential property, I focus in this paper upon commercial property.

Subject to various exemptions, from 1 April 2023, the MEES prohibit both new and existing lettings of commercial property with an EPC rating of F or G ("sub-

standard property", in MEES parlance). The government originally proposed in a consultation paper in 2019 to raise the minimum EPC rating to C by 2027, and to B by 2030, although there have been suggestions in recent months that it may be seeking to resile from this. It now appears to be the case that the Government will raise the minimum EPC rating to C by 2030. This uncertainty (highlighted by the BPF amongst others) will be unhelpful when it comes to the medium-term impact of the points discussed below.

The exemptions from the MEES are important.

- First, the MEES do not apply to short (under six months) or long (over 99 years) leases.
- Secondly, they do not apply to certain types of building (some listed buildings; those with no air conditioning or heating; various agricultural, religious or temporary buildings).
- Thirdly, they do not apply where the landlord has unsuccessfully made "reasonable efforts" to obtain its tenant's consent to carry out the necessary compliance works.
- Fourthly, they do not apply where the relevant works would devalue the property by more than 5%.
- And lastly, the MEES do not apply where all relevant works have been carried out; the property remains sub-standard; and where the further works required would not pay for themselves in seven years.

To qualify for these exemptions, the landlord will need to furnish evidence rather than rely upon assertions. While it may at first sight seem straightforward to qualify for an exemption, landlords will need guiding through the statutory requirements.

It is important to note that the MEES do not require either landlord or tenant to carry out works: they instead make it unlawful for the landlord to let or continue to let its property where it does not achieve the requisite EPC rating. So, a landlord may lawfully leave its sub-standard property vacant; or occupy it itself; or license rather than let it, which may lead to a resurgence of the old lease/licence debates.

The impact of these rules upon commercial real estate is worth emphasising. According to an investigation reported in the EG recently ("Landlords face £16bn EPC time bomb"), some 120m sq ft of commercial real estate in England would have failing EPCs in 2023 if necessary work has not been undertaken - rising to 257.2m sq ft in 2027, and 413.2m sq ft in 2030. A Carter Jonas report echoed those findings, estimating that nearly a fifth of the UK's office space is already

effectively unlettable, while nine in 10 offices in Glasgow, Edinburgh, Birmingham and Bristol would be unlettable by 2030.

So what exactly is the impact of the MEES upon the lifetime of a standard commercial lease?

MEES and lease creation

If a sub-standard property is let, the lease will still take effect as a legal estate, and the tenant will still be obliged to comply with the lease covenants. However, the consequences for the landlord will be grave, since it will have committed a breach of statutory duty, and may face substantial financial penalties and reputational damage. The landlord remains at risk of enforcement and financial penalties for so long as the tenancy remains in force and the property remains sub-standard – and for 18 months afterwards.

Whether the creation of the lease is itself a breach, the MEES should be considered when drafting the lease, as I explain below.

MEES and works during the term

A penalty notice can specify action which the landlord must take to remedy the breach and a time-frame within which it must be done. If the landlord does not comply with a penalty notice, a further penalty notice and financial penalty may be imposed.

The landlord will be unable to force its tenant to carry out the requisite remedial works, absent specific drafting in the lease; and it will be unable itself to enter the property to carry out the works unless, again, the lease makes provision for that. Given the shifting threshold for 'sub-standard property' over the lifetime of the lease, some provision for this should be included in new leases.

What if the lease terms do not allow for the works to be done? The enforcement authority can, before serving a penalty notice, serve a 'compliance notice' which requires the provision of information, including a copy of the tenancy. It is to be hoped that enforcement agencies will use this power, rather than imposing requirements in penalty notices with which the landlord cannot in practice comply.

The covenants against alterations also need considering. Whilst many leases provide that alterations may only be carried out with landlord's consent (not to be unreasonably withheld), often non-structural alterations are permitted without the need for the tenant to seek consent. Landlords will have to be vigilant to ensure that their tenants cannot inadvertently reduce the EPC rating as a result of their

alterations, particularly when carrying out air conditioning works. The inclusion within the lease of an appropriate term to this effect should be considered.

MEES and terminal dilapidations claims

Landlords may well consider that they will be able to rely upon the standard drafting most leases employ requiring tenants to carry out works required by statute, and that this will enable them to require their tenants to deliver up their premises in a MEES-compliant condition. But this will not work, because the MEES do not require works to be done; they merely render lettings of sub-standard property unlawful. So, landlords will not be able to pass on the burden of MEES compliance to their tenants, unless the lease contains a wider clause, such as a clause to comply with notices relating to the Property, and an enforcement notice has been served.

Absent such drafting, this is where life may get seriously complicated. Recall the facts of Riverside Property Investments v Blackhawk Automotive [2005] 1 EGLR 114, where the tenant succeeded in arguing that it should not be liable for the cost of a new warehouse roof, because the patch repair the tenant had carried out was good enough. Well, the tenant may now have another string to its bow: that any works of repair would be rendered nugatory by the rather greater works its landlord would have to carry out in order to be able to relet the warehouse in a MEES-compliant state.

Worse still for the landlord, the tenant may be able to argue that both limbs of s.18(1) of the Landlord and Tenant Act 1927 assist it: (a) the landlord's damages for terminal dilapidations cannot exceed the diminution in value of the property; and (b) damages cannot be recovered where the premises are to be pulled down or structural alterations are to be carried out. So, if the property is sub-standard, then the landlord bringing a claim for terminal dilapidations may face an argument that, as the property cannot be lawfully re-let, there is no diminution in value and that the landlord's claim for damages is therefore reduced to zero. If the landlord seeks to resist this conclusion by arguing that they will carry out the works necessary to achieve an energy performance indicator of E, then they risk falling foul of the second limb of s.18(1) as it might be said that such works amount to structural alterations which render the repairs covered by the tenant's covenant valueless.

So, tenants will now be able to contend that they should not be liable for works where the landlord would be bound to carry out different works in order to be able to relet. This has potentially enormous ramifications for dilapidations claims. It will surely not be long before we are treated to some judicial thinking on this topic.

MEES and rent review

A standard rent review clause in a lease will posit a hypothetical letting of the property, subject to certain assumptions. This will ordinarily require the property to be valued for letting as it stands, but assuming that the tenant has complied with its repairing obligations, and disregarding tenant's improvements. Suppose however that at the review date the property is 'sub-standard' (against whatever criteria are then in force): what is the consequence, given that the hypothetical letting must proceed?

One possible outcome is that it must simply be assumed that the letting will proceed, however unlawfully, given that this will mirror the reality. But what if the EPC rating only results from the disregard of the tenant's improvements? Is it then to be assumed that the works necessary to increase the EPC rating have been carried out; and if so, when (ie before or after the hypothetical letting), by whom, and at whose expense?

These philosophical problems worsen when it comes to the MEES exemptions considered above. The actual landlord in the real world may have qualified for an exemption – say on the basis that the actual tenant has refused its consent for the necessary compliance works. But can the same be said of the hypothetical parties? True to form, the wonderful world of rent review bristles with difficulties like these. Unhappily, the resolution of such difficulties will be achieved behind closed doors at arbitration, depriving the rest of us of the opportunity to learn how the law is developing in this new area.

MEES and lease renewal

As noted above, properly-advised landlords seeking to let their properties in this brave new world will wish to introduce protective provisions which will not merely prevent their tenants delivering their property up in a non-compliant condition, but which will also require their tenants to carry out such works as are necessary to comply with any further MEES uprating.

But at lease renewal, the introduction of such protective provisions into leases that do not already contain such drafting may at first sight be said to be unlikely to succeed. That is because, in determining the terms of the new tenancy, the court is required by section 34 of the Landlord and Tenant Act 1954 to have regard to the terms of the current tenancy and to all relevant circumstances. This is commonly interpreted to mean the replication of the terms of the old tenancy, subject only to minor amendments to reflect modern drafting practice (according to the seminal

decision of the House of Lords in O'May v City of London Real Property Co [1983] 2 AC 726).

A recent working example of this approach in the context of the MEES is provided by the decision of a recorder sitting in the Sheffield County Court on 7 March 2022 in Clipper Logistics Plc v Scottish Equitable Plc. In that case, the landlord sought to render the tenant liable to comply with the MEES through a proposed raft of new terms on the renewal of a lease granted in 2010 (and thus pre-MEES). The judge rejected most of the terms. He was however persuaded to include a clause which obliged the tenant to return the premises to the landlord with the same EPC rating as it had at the date of the new lease, as evidenced by a current EPC. The judge considered that the inclusion of that new term could be justified on grounds of essential fairness, and was a fair and reasonable change. Without that clause, the landlord would lack any meaningful protection against omissions or inaction by the tenant which could, during the course of a potential 10 year lease duration, reduce the EPC rating such that the property became sub-standard and, in consequence, bring about significant adverse consequences for the landlord. It is difficult to quarrel with that reasoning.

The landlord was not given any protection against the risk that the property would become sub-standard as a result of the changing threshold. Any attempt to introduce new clauses requiring the tenant to deliver up the premises in a way that complies with the MEES is likely to be met with some resistance in court. The tenant will say that the new clauses impermissibly shift the burden of the MEES compliance (which the rules impose on landlords and not tenants). As against that, we can see an argument that the MEES introduce an entirely new burden that was not part of the parties' original bargain when they negotiated their lease; that the MEES are one of the "relevant circumstances" in section 34 to which the court should have regard; and that a fairer approach is for the parties to share the burden.

It will be interesting to see how this plays out in court. We note some possible drafting changes below.

And lastly, what of the renewal of a lease of property that is sub-standard? It is worth noting the curiosity that the court order requiring the grant of the new lease will be mandating something that is unlawful. This is almost certainly a topic for the Law Commission to consider for reform as part of their forthcoming consultation on the 1954 Act.

Possible new Lease clauses:

The RICS's useful MEES advice note on MEES puts forward the following possible clauses:

- A right for the landlord to enter the premises to carry out energy efficiency improvement works, if the tenant (in its absolute discretion) consents. If the tenant does not consent, the landlord can rely on the third-party exemption, allowing them to continue to let the property.
- A prohibition of alterations that would otherwise be permitted, if those alterations would adversely affect the environmental performance of the premises.
- Restrictions on the tenant preventing it from obtaining an EPC unless it must do so by law (e.g. by assignment or underletting). This is to avoid the possibility that the EPC that the landlord holds for particular premises is replaced by a later EPC with a rating below E.
- I add a break clause entitling the landlord to terminate the lease if it wishes to carry out MEES improvement works – a device that I gather from my colleagues in Chambers is used frequently in practice.

So, welcome to the brave new world of the MEES. It is difficult to think of another statutory intervention in commercial property in the last forty years which will have had such a widespread and substantial effect.

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