MEES: IMPACT ON COMMERICAL TENANTS

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SUMMARY

1. The Minimum Energy Efficiency Standards ("MEES") are a set of statutory rules intended to increase energy efficiency.

2. For commercial landlords and tenants, MEES are both important and unusual. They are important because they apply to 85% of buildings let on commercial leases. And they potentially have an impact at every stage of the lifecycle of a commercial lease. The rules operate in a relatively unusual way because, whilst they impose a statutory prohibition on letting certain types of building, they do not render such lettings legal ineffective.

3. This paper will consider the impact of MEES on commercial tenants.

4. Might commercial tenants have to pay (directly or indirectly) for the energy efficiency improvements required by MEES? Or might commercial tenants even be able to exploit MEES to relieve them of obligations to which they would otherwise be subject?

BASICS

5. The aim of MEES is to reduce greenhouse gas emissions to slow global warming. Buildings are a major source of greenhouse gas emissions. The Energy White Paper: Powering our Net Zero Future (Dec 2020) stated (98):

> "…emissions from homes and from commercial and public sector buildings account for 19 per cent of total UK greenhouse gas emissions. It makes the buildings the second largest source of emissions after transport."

6. So, if you increase the energy efficiency of buildings, you will reduce the extent to which buildings contribute to carbon emissions.

7. But MEES apply only to rented properties.

8. At least in part, that is because of the "split incentive problem". If a building is let under a lease, the person who would usually invest in energy efficiency improvements (the landlord) is not the party who would be expected to reap the benefits of the increased energy efficiency in reduced energy bills (the tenant). A technical report (Overcoming the split incentive barrier in the building sector (2017)) by the Joint Research Council (a European Commission service) explains (3):

> "The landlord-tenant dilemma in rental housing and commercial leasing…is the most typical example [of an efficiency-related split incentive]. In these cases, the landlords lack incentives for investing in energy efficiency upgrades as they do not directly reap the benefit and often cannot capitalise these upgrades into higher rents due to the uncertainty over the impact of the upgrade on the property value and lack of experience on rent premiums."

9. The way MEES work is, not to require any particular energy-efficiency improvements to be carried out, but, instead, to rank the energy efficiency of buildings from A to G (in Energy Performance Certificates) and to prohibit owners from letting "sub-standard properties". Whilst, currently, properties ranked F and G are classified as "sub-standard properties", the intention is that, as time goes by, the minimum standard will be raised.

10. Section 23 of the Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 ("the MEES Regulations") is the critical provision. It provides:

> "(1) A landlord of a sub-standard non-domestic PR property [i.e. "where the valid energy performance certificate expresses the energy performance indicator of the property as being below [band E]"] must not let the property unless [certain exceptions or exemptions apply].
>
> (2) For the purposes of paragraph (1), *"let the property"* means –
>
> (a) on or after 1st April 2018, grant a new tenancy…or let the property on such a tenancy as a result of an extension or renewal of an existing tenancy, or
>
> (b) on or after 1st April 2023, continue to let the property on such a tenancy."

11. The exceptions to the prohibition on letting "sub-standard properties" include the following:

- Where the landlord has made all relevant energy efficiency improvements to the property.

- Where the landlord has been unable to increase the energy efficiency performance indictor for the property as a result of the tenant failing to co-operate.

- Where the landlord has obtained a report prepared by an independent surveyor which states that making the relevant energy efficiency improvement would result in a reduction of more than 5% in market value.

IMPACT ON COMMERCIAL TENANTS

12. So, returning to our theme, what is the impact of MEES on commercial tenants? Are they a bad thing for commercial tenants? Or, potentially, something that commercial tenants can exploit?

13. The following six points can be made.

14. **First**, it is unlikely that a tenant will be required to carry out required energy-efficiency improvements under its repairing covenant. A covenant to put a building in repair is breached only if a building is in disrepair (i.e. damaged or deteriorated). The fact that a property is energy inefficient does not cause it to be in disrepair. If part of a building that is energy inefficient is in disrepair, it can be repaired without making it energy efficient.

15. **Secondly**, the fact that a tenant is not required to carry out energy-efficiency improvements to comply with the repair covenant is reinforced by an express provision in the MEES Regulations which (rather intriguingly) makes a wider point. Regulation 2(4) provides:

> "Nothing in these Regulations affects any duty to carry out works to a property (including works to repair or to improve) imposed on a tenant, a landlord, or a superior landlord, by the terms of a tenancy agreement or by any other enactment".

16. **Thirdly**, the (perhaps surprising) reference to works to improve a property looks significant. Suppose a landlord has covenanted to repair and improve the common and exterior parts of a building. And can pass on the costs of that work in service charges to commercial tenants. Regulation 2(4) would appear to prevent the landlord passing on to the tenant the cost of improvements required only by MEES.

17. **Fourthly**, far from MEES requiring a tenant to carry out additional work under its repairing covenant, MEES will sometimes operate to limit a tenant's liability to pay damages for breach of its repairing covenant. Section 18(1) of the Landlord and Tenant Act 1927: "Damages for a breach of covenant…to

leave…premises in repair at the termination of a lease…shall in no case exceed the amount (if any) by which the value of the reversion…in the premises is diminished owing to the breach." A tenant will sometimes be able to argue that, as a result of MEES, its failure to repair an item has not reduced the value of the reversion. For example, the tenant might be able to argue that, had it carried out the repair works, the property would have an EPC rating of F or G; when valuing the reversion, you should assume that the notional buyer of the reversion would relet; the buyer of the reversion would be unable lawfully to relet without carrying out energy efficiency improvements; those improvements would supersede some of the tenant's repair work; and that would reduce the amount by which the disrepair diminished the value of the reversion. In consequence, the tenant's liability to pay damages would be reduced.

18. **Fifthly**, the scope for a court hearing a lease renewal to foist on a tenant covenants requiring the tenant to carry out works etc. to increase energy efficiency is limited. Section 35(1) of Part II of the Landlord and Tenant Act 1954 provides that, when determining the terms of a new tenancy, the court "shall have regard to the terms of the current tenancy and to all relevant circumstances". It is quite hard for a landlord to persuade a court to include fresh terms in the lease (O'May v City of London Real Property Co Ltd [1983] 2 AC 726). New leases tend to contain the same terms as the old lease subject to minor amendments to reflect modern drafting practice. Given that the obligation to comply with MEES Regulations is imposed on landlords, a court on a lease renewal is unlikely to be receptive to an argument by a landlord that fresh lease terms should be included requiring the tenant to undertake energy efficiency improvements. However, in Clipper Logistics Plc v Scottish Equitable Plc (County Court at Sheffield, 7 March 2022), the court included in a new lease a covenant requiring the tenant to "return the premises to the Landlord with the same EPC rating as it has at the date of this Lease as evidenced by the EPC dated 1 June 2021." Mr Recorder McNamara said [39]:

> "Without this clause, the Defendant would, in my judgment, lack any meaningful protection against omissions/inaction by the Claimant which could, during the course of a potential 10 year lease duration, reduce the EPC rating such that the property because sub-standard and, in consequence, [expose the landlord to financial penalties for continuing to let a substandard property]."

19. **Finally**, MEES regulations might assist tenants on rent reviews. This is a big subject. But the rent under a lease is typically reviewed to the market rent under a hypothetical lease of the premises as they stand, but assuming that the tenant has complied with its covenants and disregarding tenant improvements. Suppose that the premises are sub-standard under MEES Regulations and so cannot be lawfully let. Or suppose that the premises would be sub-standard if the tenant's fit-out works are disregarded - as the disregard of tenant improvements would suggest. Presumably, you would assume an unlawful letting. The tenant might argue that this would depress the rent because, for example, the tenant's energy bills would be higher. Or because the tenant will not be able to lawfully sub-let.

20. We can conclude this review by saying that, whether it be on a rent review or on a terminal dilapidations claim, there are real opportunities for commercial tenants to exploit MEES for their commercial advantage.