California Becomes the First State to Require Energy Usage Disclosures by Commercial Property Owners

*Leslie Criswell**
*Matthew I. Kaplan***
Tucker Ellis & West LLP
Los Angeles, CA

*Daniel K. Wright II****
Tucker Ellis & West LLP
Cleveland, OH

Just as automakers have used "miles-per-gallon" labels for years to advertise fuel efficiency, the real estate industry is now being pushed to use similar labels to become more transparent, energy-conscious and fuel-efficient.

In 2012,[1] owners and operators of non-residential buildings in California, which are solely owner-occupied, or which contain a total floor area measuring 50,000 sq. ft. or more, must disclose the building's U.S. Environmental Protection Agency (EPA) Energy Star® Portfolio Manager benchmarking data and ratings for the most recent 12-month period to any prospective buyer, lessee of the entire building or lender that proposes to finance the entire building.[2] Although the California Energy Commission's proposed phase-in schedule initially set a Jan. 1, 2011, start date for these requirements, the Draft Regulations have not yet been formally adopted, and it is now estimated that the program will begin in 2012. The Draft Regulations also originally required these same disclosures for non-residential buildings containing 10,000 sq. ft. to 50,000 sq. ft., beginning Jan. 1, 2012, and for all non-residential buildings containing more than 1,000 sq. ft., beginning July 1, 2012. (See AB1103/AB531, codified at California Public Resources Code, § 25402.10.) These dates will slip into late 2012 or 2013, as a result of the continued delays in implementing this Regulation.

While these are the first such state-wide regulations in the country, Washington D.C., New York City and Seattle require annual public disclosure of similar information on energy usage. It is quite possible that other large metro areas will also require annual public disclosure of similar information on energy usage, and that these regulations will become a standard for the real estate industry.

Operation of California's Regulations

The stated goal of these Regulations is to encourage owners to manage energy use and achieve a 20 percent reduction in energy use by 2015. The schedule was developed by the California Energy Resources Conservation and Development Commission, after conducting studies and collecting data directed at reducing costly and inefficient energy use.

For those owners and operators of commercial property that have already voluntarily enrolled in the EPA's Energy Star® Portfolio Manager database, these mandatory disclosures may be fairly painless. For others, however, the challenges could be substantial.

Shopping Center Legal Update is published by the Legal Department of the International Council of Shopping Centers, Inc., 1221 Avenue of the Americas, 41st floor, New York, NY 10020-1099; *David Henry*, Chairman; *Michael P. Kercheval*, President & CEO; *Gregory Peterson*, General Counsel.

To start, it is imperative that a building's energy score be accurately calculated, as inaccurate disclosure could create liability to those who rely upon the disclosures in the purchase, leasing or financing of a property. Potential claims include intentional or negligent misrepresentation, statutory claims such as violation of California's Unfair Competition Law (found at Business & Professions Code, § 17200) and even fraud. Individuals who may have the standing to make such claims include buyers, tenants and lenders. Potential remedies include actual damages, restitution and possible potential punitive damages.

The Energy Star® website, www.energystar.gov/index, contains helpful suggestions for gathering and tracking energy use data; but determining the appropriate level of detail to be used for purposes of data collection and reporting will vary from organization to organization and from property to property. Some may find it appropriate to use smart meters and submeters. For others, the total cost on the monthly utility bill may be sufficient. All energy sources should be accounted for in physical units (i.e., kilowatt hours for electricity, million cubic feet for natural gas, etc.) and on a cost basis. Energy Star® recommends gathering at least two years' monthly data, if available, to formulate a benchmark.

The California regulations require that, at least 30 days before a disclosure must be made to a third party, a building owner must open an account at the Energy Star® Portfolio Manager website. In that account, the building owner must provide contact information, the building identity and Portfolio Manager building type, and the building characteristics. The owner also must identify all utility company meters and utility company accounts serving the building, and authorize all utility companies serving the building to release energy use data for the most recent 12-month period into the owner's Portfolio Manager account.

Within 15 days of an owner's request, a utility company must upload the entire building's energy use data into the owner's Portfolio Manager account. The Regulations prohibit the utility company from releasing tenant energy use data for any purpose other than compliance with Public Resources Code, § 25402.10, and also prohibit the owner from using or releasing any tenant energy use data for any purpose other than compliance with the law.

The data in the owner's Portfolio Manager account is then used to generate a Statement of Energy Performance for the building as well as a California Energy Performance Disclosure Report that is to be electronically submitted to the California Energy Commission. Actual data, not estimates, is required. Monthly updates are worthwhile. An audit team with appropriate expertise can then help plan and develop an energy audit strategy, with periodic progress reports.

Suggested best practices for data collection and reporting include having only knowledgeable building personnel collect the raw data, and retaining a knowledgeable and experienced third-party energy consultant or engineering firm to review and evaluate the data for accuracy.

The EPA's benchmark or "target" energy efficiency score for a particular property type is identified on a scale of 1-100; buildings that have a score of at least 75 are eligible for the Energy Star® label. Unfortunately, at the present time, the EPA's Energy Star® Portfolio Manager only provides benchmarks for office buildings, K–12 schools, grocery stores, hospitals and hotels. Accordingly, for parties owning a property that does not fit into one of these categories, benchmarking and accurate Energy Star® ratings may be problematic. While the EPA plans to add additional types of buildings to its system of benchmarks in the future, it has not yet set a timetable for doing so.

New Law Creates Conundrum for Landlords and Tenants

California's new requirements create some grey areas for landlords, tenants and utilities—particularly, in situations where existing lease language does not require the tenant to disclose energy use data to the landlord and the tenant refuses to do so. The California Energy Commission has wrestled with these issues for the last two years.

- One proposed solution is for utility companies to release energy use totals for the entire building to the owner's Portfolio Manager's account.
- Another option is for the utility companies to create a "virtual meter," which identifies, by tenant, all energy use. This information would also be downloaded in the owner's Portfolio Manager account. Utilities have, quite understandably, been concerned about breaching confidentiality rights; therefore, it is anticipated that utilities may require that owners sign non-disclosure agreements.
- Another option being discussed by the California Energy Commission is the possibility of requiring an owner to rate only permanent "energy assets" in a building—for example, HVAC (heating, ventilation, air-conditioning) systems, elevators, lighting and chillers.

There is, as yet, no official rating information of this nature for such permanent assets. Energy asset ratings are expected to be developed, but it could be quite some time before they are available. And, it may take even longer before they are integrated into the California Energy Commission's regulatory framework. Therefore, stay tuned ….

Things to Consider
Absent a legislative "fix" on these issues, landlords should consider the following:

1. Examine existing leases. While lease provisions requiring the tenant to comply with applicable law may be helpful in this instance, a narrowly drawn provision may be problematic. Similarly, non-disclosure provisions (such as those found in percentage rent/gross sales clauses), if overly broad, also may be problematic. If existing lease documents do not contemplate disclosure of information on energy usage as required by the statutory scheme, the landlord should seek voluntary compliance from the tenant, and perhaps consider an amendment to the lease to formalize the parties' agreement as to future compliance.
2. Both landlords and tenants should consider including lease language that addresses the disclosure and use of information relative to energy usage, including issues relative to privacy, confidentiality and trade secrets, as well as remedies short of termination and eviction for the breach of such provisions.

Conclusion
California's energy disclosure requirements are likely only the beginning for building owners, as there is continued growth in the public's awareness of the cost of energy dependence on foreign sources and concern about the risks of global warming. The early implementation of compliance programs will provide a competitive advantage for landlords as they develop information about properties in their portfolios and are able to identify areas for cost savings through the adoption of energy use reduction programs. Such programs also may lessen legal expenses that arise from the adoption of a compliance program at the last minute or (even worse) under threat of an enforcement action by state authorities.

*LESLIE CRISWELL is a Partner in the Los Angeles office of Tucker Ellis & West LLP, specializing in the defense of a broad range of lawsuits against premises owners and managers, among others.

**MATTHEW I. KAPLAN is a Partner in the Los Angeles office of Tucker Ellis & West LLP, where he litigates a wide range of complex commercial litigation for property owners, managers and lenders.

***DANIEL K. WRIGHT II is a Member of the Real Estate Group in Tucker Ellis & West LLP's Cleveland office, where he specializes in real estate development, finance and leasing transactions.

[1] The exact date has not yet been set, as the Draft Regulations implementing AB1103 have not been formally implemented as of June 16, 2011.

[2] "Entire building" is defined as "the portion of the building for which the owner possesses title."