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High-Performance Leases: A Solution for Reducing Carbon Emissions in Commercial Buildings

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Part I: Carbon Emissions and Commercial Buildings

COVID-19 abruptly shut down the world and has significantly impacted New York City's commercial real estate market. This disruption provides companies an unprecedented opportunity to rethink the fundamentals of their physical and virtual workplaces, including how to reduce operating expenses and reduce carbon emissions from commercial buildings. The pandemic has also revealed that status quo leasing practices tend to lock in inefficient

procedures and impede efforts to reduce carbon emissions. In this article, we propose widespread adoption of high-performance leasing as a solution to removing carbon from office buildings. High-performance leases equitably align costs and benefits of energy savings between landlords and tenants, and can position the real estate industry to comply with emerging local and state carbon regulations applicable to the built environment. The Institute for Market Transformation, a leading nonprofit working in this space, is partnering with the New York City Climate Action Alliance to promote high-performance leasing in New York City, which recently enacted a cap on carbon emissions from buildings (known as Local Law 97).¹

Over two-thirds of New York City's carbon emissions come from buildings. Local Law 97 sets a cap on carbon emissions that takes effect in 2024 and becomes increasingly stringent thereafter. Most privately owned buildings over 25,000 square feet are subject to the law, and owners of these large buildings face significant penalties for non-compliance. Tenants, however, are responsible for at least half of all energy use in commercial buildings—presenting a significant challenge for commercial landlords to comply with Local Law 97 if their tenants are not also engaged through their leases in energy efficiency measures.

Not only do many tenants consume more energy than necessary, but their leases obligate landlords to provide extra energy even when it is not needed. These lease provisions act as a barrier for either party to prioritize energy efficiency, and the pandemic offered a stark illustration of the inability of traditional leases to advance efficient energy use and carbon reductions. While occupancy fell to historic lows in 2020, building energy use only

¹For more information on Local Law 97, see Alexis Saba & Adam Stolorow, *Affordable Housing and Climate Mitigation in New York City: Compliance and Financing Options for Building Owners Under Local Laws 97 and 116*, 32 ENVTL. L. N.Y. 19 (Feb. 2021); see also Noah Kaufman & Yu Ann Tann, *New York City's Building Emissions Law Shows the Importance of Economy-Wide Climate Policy*, 32 ENVTL. L. N.Y. 35 (Mar. 2021); Danielle Manley et al., *Trading: A New Climate Solution for New York City's Buildings*, 32 ENVTL. L. N.Y. 1 (Jan. 2021).

dropped 10–20% for most companies, as shown in a Johnson Controls study conducted in September 2020.² The explanation lies in lease terms that require landlords to provide heating and cooling even when leased spaces are unoccupied, permit inefficient tenant buildouts, hardwire lights to stay on 24/7, and mandate excessive plug loads (energy used by equipment that is plugged into an outlet). These terms compelled building owners to overuse energy in empty spaces while occupants worked from home.

Unlike residential leases, commercial leases are largely unregulated and are not subject to consumer protection laws. Commercial leases are also generally much longer in duration (five- to 10-year terms, often, plus renewal options), with high penalties for noncompliance with lease terms. All of this means it can be difficult to improve commercial leases during the lifetime of a lease; their terms are mostly cemented into practice until the lease is up for renewal. Better leasing practices are needed to prioritize energy efficiency investments and help New York City meet its ambitious climate goals.

Part II: Introduction to High-Performance Leasing

Adding high-performance, energy-aligned terms to a conventional lease can improve the business deal, make it more responsive to current conditions, contribute to a cleaner environment, and harvest cost savings for both building owners and tenants. At the core of this pragmatic approach to advanced leasing practices is a mutual agreement of both tenants and landlords to collaborate and create shared benefits. This approach involves identifying priorities both parties support such as health, wellness, and energy efficiency; defining how building and tenant spaces will operate; and establishing data sharing and clear channels of communication. This cooperation, which is built into the lease, forms the basis for an ongoing partnership that can and should be leveraged over time by shared reporting on progress toward energy efficiency goals.

High-performance leases build upon the Institute for Market Transformation's Green Lease Leaders program, which launched in 2014 in coordination with the U.S. Department of Energy's Better Buildings Alliance.³ Green Lease Leaders is a recognition program that created an initial framework for what constitutes an energy-aligned lease, and established clauses and operational procedures that advance efficient and carbon neutral buildings. With the passage of Local Law 97 in New York City and emerging

interest in building performance standards around the country, leases must expand beyond the fundamentals established from earlier green leasing practices—which encourage building owners and tenants to include energy-aligned clauses on a voluntary basis—to incorporate terms that mandate compliance with increasingly stringent energy and carbon requirements. These high-performance leases include provisions that:

- Set building performance standards to meet carbon reduction goals;
- Equitably distribute landlord and tenant responsibilities to meet building performance standards;
- Ensure landlord-tenant transparency and accountability by tracking energy use and implementing building performance goals;
- Offer continuous monitoring via periodic recommissioning studies,⁴ and mitigating plans where necessary; and
- Present remedies should either party fail to meet building performance goals.

New York City real estate owners and tenants could send a powerful signal to other markets by adopting high-performance, energy-aligned leasing practices. If such leases become the industry standard, they would help scale this climate solution to the level necessary to meaningfully reduce emissions from buildings and create healthier, more efficient tenant spaces.

Part III: Key Provisions in the Performance-Based Lease

The Institute for Market Transformation, working with attorneys associated with the New York City Climate Action Alliance, has developed a model performance-based lease that seeks to achieve the twin objectives of energy efficiency and carbon reduction by balancing the economic burden and benefits of space design and retrofits to achieve such goals. This section describes the key goals of the performance-based lease and includes excerpts of relevant provisions.

² Johnson Controls, 2020 Johnson Controls Energy Efficiency Indicator Study: COVID-19 Pulse Survey (2020), https://www.johnsoncontrols.com/-/media/jci/insights/2020/feature-story/files/hq2010004_eei-2020-media-one-page-summary-v3.pdf.

³ See GREEN LEASE LEADERS, <https://www.greenleaseleaders.com/> (last visited Apr. 12, 2021).

⁴ Recommissioning is the process of ensuring that the energy systems in an existing building are installed as per the design intentions, functionally tested, and capable of being operated and maintained, according to the owner's operational needs. During a recommission, a certified professional identifies deficiencies in specific equipment types, and corrects the deficiencies to ensure the equipment can operate as intended.

A. Setting Building Performance Standards to Meet Carbon Reduction Goals

The fundamental principle coursing through the model performance-based lease is the prioritization of energy efficiency and carbon reduction in building operations. To accomplish this goal, the first critical component of the model lease is establishing performance standards. The lease contemplates that the landlord will identify operational and construction standards for the building (the “Building Performance Standards”), which will be included as an exhibit to the lease. The Building Performance Standards will be designed to reduce energy used in building operations, and would reflect the requirements of Local Law 97 in New York City and/or other provisions of applicable law elsewhere. The Building Performance Standards would include the energy consumption goals for the building and articulate the capital improvements that must be undertaken to meet the goals.

In addition to the exhibit establishing the Building Performance Standards, the model lease calls for the development of a separate exhibit that applies the Building Performance Standards to the relevant tenant space. This exhibit will define the energy consumption limit and/or the plug load standard for the tenant space, allocating to the tenant its equitable pro rata shares of power available to the building within applicable energy budgets. The exhibit would also include certain design criteria for the tenant space to achieve required efficiencies and therefore the Building Performance Standards.

Relevant Provisions:

- Definitions section: Defines “Building Performance Standards,” “Energy Consumption Limit,” “Plug Load Standard,” and “Premises Design Criteria” as the standards and criteria set forth in the relevant exhibits.
- § 5.2(f): The Landlord may withhold approval from any “Initial Improvements” that “fail to comply with the Building Performance Standards or Premises Design Criteria.”
- § 6.2.1: The Tenant, at its expense, shall comply with Landlord’s Building Performance Standards, the Tenant’s Energy Consumption Limit, the Premises Design Criteria, and the Tenant’s Plug Load Standard.
- § 10.1.1(i): Any future Tenant Alterations must comply with Landlord’s Building Performance Standards or Premises Design Criteria.

B. Shared Responsibility to Meet Building Performance Standards

To help achieve compliance with the Building Performance Standards, the model performance-based lease sets forth specific landlord and tenant obligations, and offers ways for both parties to share the costs of meeting them. For example, the model lease

requires that the tenant comply with the energy consumption limit, the plug load standard, and design criteria for the tenant spaces. To support the tenant’s compliance efforts, the model lease requires that the landlord pay the tenant a bonus for making the improvements within its leased space that are necessary to comply with the standards. The bonus is spread out over the term of the lease and payable to the tenant as a credit against monthly installments of rent. This provision enables the landlord and tenant to share the cost of fitting out tenant spaces in a manner designed to meet the building’s carbon reduction goals.

The model lease also requires the tenant to contribute its fair share of the landlord’s cost of meeting the Building Performance Standards. In a traditional lease, landlords pass certain costs of capital improvements through to tenants as building operating expenses. The model lease extends this concept to include the costs of the improvements necessary to comply with greenhouse gas emissions and energy reduction laws. This enables base building system retrofits and necessary upgrades identified during building recommissioning to be passed through to tenants in proportion to their use of building-wide services.

Relevant Provisions:

- § 4.4.1(i) & (m): “Operating Expense” includes the “costs to comply with Laws and governmental requirements of general applicability to the Building ... the purpose of which is to cause a reduction in greenhouse gas emissions or energy use intensity” and “the costs to comply with Building Performance Standards,” including the costs of recommissioning and implementation of resulting recommendations.
- § 5.3: Landlord shall pay to Tenant an “Energy Efficiency Bonus” equal to []% of Landlord’s Contribution [for initial tenant premises improvements], provided that, upon completion of the Initial Improvements, a qualified licensed professional engineer paid for by Tenant and reasonably acceptable to Landlord certifies to Landlord that the Initial Improvements have been substantially completed in a manner which meets or exceeds Landlord’s Building Performance Standards, which Energy Efficiency Bonus shall be amortized over the Term of the Lease and payable to Tenant as a credit against monthly installments of Base Rent....”
- § 6.2.1: The Tenant, at its expense, shall comply with Landlord’s Building Performance Standards. The Tenant shall also comply with any federal, state, or local laws applicable to the reduction of greenhouse gases or the use of sustainable materials, to the extent such laws are applicable to Tenant.
- § 10.1.1(i): Any future Tenant Alterations must comply with Landlord’s Building Performance Standards or Premises Design Criteria.

C. Landlord-Tenant Transparency and Accountability

The model performance-based lease also ensures that landlords and tenants will have equal access to information about tenant and building energy consumption. This sharing of information enables all parties within the building to identify and address inefficiencies in energy usage, learn from each other, and foster a more collaborative relationship. The model lease requires a submeter to be installed in each tenant space and provides that landlords will bill tenants according to the tenant's actual energy usage rather than estimates or other less reliable proxies. This arrangement makes tenants accountable for their actual energy consumption. The model lease extends the submetering requirement to building common areas, requiring the landlord to maintain submeters to measure the energy consumption in those areas and to share this information with all tenants. This requirement helps hold the landlord for optimizing its building energy systems, and at the same time can provide substantiation for operating expense charges to tenants. The model lease also requires that the results of periodic recommissioning be shared between tenants and landlords, and that landlords share information about building-wide energy performance ratings with tenants.

Relevant Provisions:

- § 8.1: Tenant's consumption of electrical energy at the Premises shall be measured by meters (capable of reading demand and KW hours to measure the demand and consumption of electric energy) installed at the Premises by Landlord at Tenant's sole cost and expense.
- § 8.3: Landlord shall provide Tenant with an annual energy use summary indicating the energy consumed in any Building Common Areas (total and kilowatt hours/square foot) and the energy consumed in the Building as a whole (total and kilowatt hours/square foot) the previous year. Landlord shall also provide Tenant the Building's ENERGY STAR score.

D. Periodic Recommissioning

Periodic recommissioning—of both tenant space facility systems and landlord base building systems—is crucial to ensure that Building Performance Standards are met. Sharing professionally accumulated information about these systems will allow the parties to evaluate best practices and identify ways to improve energy efficiencies. The model performance-based lease requires a recommissioning of the tenant space every three to five years, which includes an evaluation of plug load consumption, water consumption, and operating hours. In addition, the tenant is required to perform a biannual “night audit” to ensure that no unnecessary energy is being consumed overnight. Finally, if a tenant exceeds the energy consumption limit and/or plug

load standard in any given year, the model lease authorizes the landlord to arrange for the tenant's space to be recommissioned ahead of the standard recommissioning timeline. After tenant recommissioning, the model lease calls for the landlord and tenant to meet to review the results and recommendations and mutually establish an energy optimization plan. The tenant is responsible for the costs of implementing the recommendations of the recommissioning.

The model lease also requires that the landlord recommission the base building systems and common areas once every three calendar years. The landlord will undertake the recommendations of the recommissioning as an operating expense, which, as noted above, can be passed through to the tenant.

Finally, the model lease addresses what happens if the Building Performance Standards are not met. In that scenario, the model lease requires the landlord to meet with non-compliant building tenants and review each such tenant's energy use data, recommissioning results and recommendations, and the effectiveness of current efficiency programs. The landlord and each such tenant would then work together to mutually establish an energy optimization plan, which would include an energy management plan and identify cost savings opportunities for the building and each tenant space.

Relevant Provisions:

- § 9.7.1: Prior to the recommissioning set forth in § 9.7.2, every [3] calendar years, Landlord will work with a Tenant point of contact to issue a survey to all occupants of the Premises to evaluate thermal comfort, functionality, transportation methods, health and productivity, and Tenant operations, including the type of equipment used, lighting systems, plug load management, and hours of operations. Survey results will be used to inform recommissioning to improve the functionality and comfort of the Premises. Surveys shall be coordinated through the designated Tenant point of contact and shall not occur more than once per calendar year. Interviews may be used to supplement the surveys, pending approval from the Tenant point of contact.
- § 9.7.2: In order to maintain and enhance performance toward the Building Performance Standard, the Landlord will recommission the Building Systems, including, but not limited to, base building systems and common areas, once every [3] calendar years. The cost of recommissioning will be billed to all tenants of the Building as an Operating Expense. Each recommissioning will comply with ASHRAE Guideline 0.2 (for initial commissioning and retro-commissioning of base building systems) or ASHRAE Guideline 202 (for new commissioning of tenant fit out equipment). The Landlord will evaluate specific commissioning standards at each [3 year] interval,

and update the standards as appropriate. At a minimum, recommissioning will address heating, ventilating, air conditioning and refrigeration (HVAC&R) systems and associated controls, lighting and lighting controls, plug loads, and domestic hot water systems.

- § 9.7.3: The Landlord shall share the results of the recommissioning with the Tenant. The recommendations of the recommissioning will be promptly undertaken by Landlord as an Operating Expense.
- § 9.7.4: If the Building Performance Standard set forth in Exhibit C is not achieved, Landlord will meet with all tenants and review energy use data, recommissioning outputs and recommendations, and the effectiveness of efficiency programs and mutually establish an energy optimization plan (“Energy Optimization Plan”), including energy management and cost-effective savings opportunities for the Building and each premises therein. The cost of any changes or alterations to the base building HVAC or lighting systems and their controls due to the recommissioning will be borne by Landlord and billed as an Operating Expense.
- § 9.8.1: Tenant shall perform a recommissioning study of all systems that consume energy, including, but not limited to all equipment (including plug loads) installed at the leased premises; all systems that consume water; and tenant space operating hours every [3–5] years. Within [2–3] months after the conclusion of the recommissioning study, the Tenant shall start to implement recommendations identified by the recommissioning study that are deemed cost effective. For purposes of this section, the term “cost effective” means an improvement that will result in material operational cost savings by reducing electricity or fossil fuel consumption, water, or other utility costs and where such operational cost saving over the then-remaining Term of this lease (or some other period of time that is mutually acceptable) is sufficient to pay the incremental additional costs of making the improvements.
- § 9.8.3: Tenant shall perform an audit at night at least 2 times per year, once in the summer and once in the winter, to check set points, equipment that should be powered down leasing hours, night load, and lighting.
- § 9.8.4: If the Tenant’s consumption of energy exclusively serving the Premises exceeds the energy usage limit equitably allocated to the Premises as set forth in Exhibit D, or if the Tenant’s Plug Load Maximum set forth in Exhibit D is exceeded, Landlord will arrange for the Premises to be recommissioned, and cost of any changes or alterations to the Premises or equipment and its controls due to the recommissioning will be promptly done by Tenant at its sole cost.

E. Penalties

Finally, for buildings that are subject to a law that requires certain emissions targets and imposes a penalty if those targets are not met, such as New York’s Local Law 97, the model performance-based lease allows landlords to pass through penalties to tenants in proportion to their contribution to such penalties.

Relevant Provision:

- § 6.2.1(a): Tenant shall ... comply with (i) Landlord’s Building Performance Standards set forth in Exhibit C and (ii) all Laws ... with respect to the Premises, including, without limitation, (i) any improvements or Alterations in the Premises and Tenant’s occupancy, use and manner of use of the Premises and (ii) the payment of any portion of the penalties or excess emissions charges incurred by Landlord under Local Law 97 equitably attributable to Tenant’s consumption of energy exclusively serving the Premises in excess of the energy use limit equitably allocated to the Premises as set forth in Exhibit D based on the Building’s emissions limit in the aggregate which causes Landlord to exceed the annual building emissions limit Landlord is required to comply with under such Local Law 97 for such calendar year in question (taking into consideration any and all credits with respect to such limit obtained by Landlord, if the cost of such credit is included in Operating Expenses); provided however, in connection with the foregoing, Landlord shall have the burden to demonstrate to Tenant, through means and methods reasonably acceptable to Tenant, that any such liability of Tenant under this Section 6.2.1, or elsewhere in this Lease in connection with Local Law 97, is equitably attributable to Tenant’s consumption of energy; and provided, further, that, Landlord shall be solely responsible, and shall not hold Tenant accountable, for any portion of any penalties or charges levied upon the Building under Local Law 97 due to (i) the failure of Landlord to timely or duly meet reporting obligations under Local Law 97, (ii) to the consumption of utilities by any other tenant or occupant of the Building, (iii) any extraordinary use of Building Systems in the Common Areas during periods outside of a Business Day, or (iv) Landlord’s failure to operate and maintain the Building Systems in accordance with the standards from time to time prevailing for comparable first-class office buildings in midtown Manhattan.

Part IV: What’s Next

High-performance leasing is a critical tool in the toolbox to reduce carbon emissions from buildings, but it must first become standard practice in commercial lease negotiations. This will not happen until all stakeholders are aware of the limitations of conventional leasing practices and the benefits of high-performance lease terms, and are motivated by regulations such as Local Law 97 to reduce energy consumption and carbon

emissions in buildings. The Building Energy Exchange, the Institute for Market Transformation, and the New York City Climate Action Alliance, with funding from the New York State Energy Research and Development Authority (NYSERDA), have launched a robust initiative to integrate high-performance leasing and other tools into leased office space negotiations. This initiative, which recently kicked off, will engage stakeholders at each stage of the leasing and facility management process to help tenants and building owners save money, create sustainable and healthy workplaces, meet local and state environmental and public health regulations, and reduce energy use and carbon emissions. The two-year effort will result in pragmatic and actionable resources (including the model high-performance lease) to facilitate meaningful collaboration between building owners, tenants, brokers, lawyers, designers, and others involved in leasing and office utilization decisions to drive decarbonization in tenant spaces.

The high-performance lease is a critical part of this effort. With the recent enactment of Local Law 97, and the many challenges presented by COVID-19, business as usual is not an option. The model performance-based lease provisions are a key step to encourage greater collaboration and strategic partnerships between building owners and tenants by equitably aligning the costs and benefits of energy efficiency investments.

To introduce high-performance lease provisions to building owners, tenants, brokers, and leasing lawyers, the Building Energy Exchange, Institute for Market Transformation, and New York City Climate Action Alliance will select and train a highly qualified Speakers Bureau to act as ambassadors and educators of the tool. We not only want to develop these resources, but also make them widely known to and used by critical stakeholders at the most appropriate time to drive sustained decarbonization of the built environment. If you would like to receive the model performance-based lease once it is publicly released in June 2021, or to learn more about these lease provisions and how they could be helpful to you or your clients, or if you are interested in becoming an ambassador to promote high-performance leasing practices, please contact us at ComTenantEfficiencyNYC@be-exchange.org.

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The Institute for Market Transformation (IMT) is a national 501(c)(3) nonprofit organization that catalyzes widespread and sustained demand for energy-efficient buildings. Founded in 1996 and based in Washington, D.C., IMT leverages its expertise at the intersection of real estate and public policy to make buildings more productive, affordable, valuable, and resilient.

A trusted, non-partisan leader, IMT focuses on innovative and pragmatic solutions that fuel greater investment in energy-efficient buildings to meet local market priorities. IMT offers hands-on technical assistance and market research, alongside expertise in policy and program development and deployment and promotion of best practices and knowledge exchange. Its efforts lead to important policy outcomes, widespread changes in real estate practices, and lasting market demand for energy efficiency—resulting in greater benefits for all people, the economy, and the environment.

The New York City Climate Action Alliance (Alliance) is a non-profit that aims to accelerate New York City's equitable transition to a zero-carbon future. By building a network of New Yorkers from all walks of life who are committed to achieving New York City's ambitious climate goals, we aim to spur climate action and tackle seemingly intractable climate challenges. Harnessing the ingenuity, inspiration, and innovation of this inclusive and non-partisan alliance, we educate, engage, and empower New Yorkers to scale up proven climate solutions in their everyday lives.