

# Legal Update

## Electricity in Commercial Leases

November 2012

Given the volatility in energy costs from time to time, it is possible that utility costs, too, could be subject to change. It is imperative that both landlords and tenants of commercial leases understand the issues relating to electricity in their current leases or when entering into a new lease. This newsletter summarizes the three most commonly used methods of billing commercial tenants for electricity in New York City and issues for both landlords and tenants to carefully consider with respect to each method.

### Direct Services

Perhaps the simplest form of obtaining electricity is to have the tenant obtain electrical service directly from a utility company. There are few issues between the landlord and the tenant since the tenant pays its electricity bills directly to the utility company based on meter readings for the tenant's premises and with no surcharge to the landlord. Note that it may be necessary for the landlord to allow the tenant access to equipment or risers.

#### Issue to consider:

- At whose cost will the electricity meter be installed and maintained in the tenant's premises?

### Submetering

Many commercial buildings in New York City buy electricity wholesale from a utility company and sell it retail to its tenants. For the tenant, buying electricity from the landlord may be preferable over direct service because the landlord's wholesale rates are often cheaper (even with a reasonable retail mark-up) than the rates the tenant can obtain directly from the utility company.

### Contact Us:

To discuss further, please contact your primary Kleinberg Kaplan attorney or:

Andrew Chonoles  
212.880.9870  
[achonoles@kkwc.com](mailto:achonoles@kkwc.com)

Ross Yustein  
212.880.9848  
[ryustein@kkwc.com](mailto:ryustein@kkwc.com)

When the lease calls for submetering, the landlord furnishes electricity to the premises and the tenant pays the landlord for its use of electricity based on meter readings for the premises. However, the landlord will often add an additional fee (usually a percentage of the wholesale fee) for its overhead, administration and/or supervision, sometimes at a profit for the landlord. Usually, the landlord will also reserve the right to increase the rates it charges the tenant if the rates the landlord pays the utility company or taxes for the electricity increase.

Issue to consider:

- At whose cost will the electricity submeter be installed and maintained in the tenant's premises?
- Is the landlord's additional fee for its overhead, administration and/or supervision reasonable? Is it sufficient to cover the landlord's costs?

### **Rent Inclusion**

Provided that the landlord purchases electricity wholesale from a utility company, the third common method for paying for electricity is to include a fixed amount that the tenant will pay each month for electricity furnished by the landlord, regardless of how much or how little electricity is actually used by the tenant. This method is often chosen because the electricity charge each month is a somewhat predictable and stable amount, and also eliminates the cost and administrative burden of installing, reading submeters and billing.

However, many leases that utilize the rent inclusion method will include a right for the landlord to cause a survey or inspection of the tenant's premises to determine the value of the electric service furnished to the tenant. In that way, a landlord is protected if the fixed rent inclusion amount does not fairly reflect the value of the electricity utilized by the tenant (*i.e.*, if the tenant uses significantly more electricity than predicted). Although the survey and inspection may increase the fixed rent inclusion amount, most leases will not allow it to reduce the fixed rent inclusion amount. Also, generally the inclusion amount will increase if the utility rates increase.

Issue to consider:

- If the landlord has a survey and inspection right to increase the fixed rent inclusion amount, what rights will the tenant have to dispute such survey and inspection? The tenant should require that the survey be conducted by an independent engineer and that the lease allows the tenant to conduct its own survey by an independent engineer to timely dispute the landlord's survey results. Additionally, a mechanism will need to be put in place to resolve any conflict between the landlord's and the tenant's survey results.

**Additional Issues to Consider Outside the Scope of This Newsletter**

- If the landlord fails to furnish the electricity to the tenant's premises for an extended period of time, will there be a rent abatement? And in such case, will the tenant be allowed to obtain direct service from the utility company?
- Under what circumstances may the landlord elect to change the electrical billing method described above to another (*e.g.*, change from submetering to direct service)?

**This Alert Provides General Information Only and Is Not Intended as Legal Advice.**

©2012 Kleinberg, Kaplan, Wolff & Cohen, P.C. All rights reserved.

Attorney Advertising