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Landlords in Germany Will Soon Have to Bear Part of the CO_2 Costs for Heat Supply

By Dr. Jan Gernoth & Hannes Riedel

On 25 May 2022, the German Federal Cabinet submitted a draft of the Carbon Dioxide Cost Sharing Act (Kohlendioxidkostenaufteilungsgesetz – CO_2-KostAufG).[1] This bill intends to regulate the sharing of costs for CO_2 emissions regarding heating and hot water supply between landlords and tenants. The intention is to incentivize tenants to behave in more energy-efficient ways and to encourage property owners to carry out energy modernization measures.

Since Germany enacted the Fuel Emissions Trading Act (*Treibstoff-Emissionshandelsgesetz – BEHG*), effective as of 1 January 2021, a CO_2 levy must be paid when conventional energy sources such as liquid fuels, gas, or heating oil are used. Utility companies have passed on these new CO_2 levies to their customers. Under most German lease agreements, landlords are entitled to further pass on these levies to their tenants as part of an annual reconciliation of service charges—i.e., currently, tenants in Germany effectively bear the economic responsibility for this CO_2 levy.

With the current draft Carbon Dioxide Cost Sharing Act, this landlord practice will be considerably restricted; in the majority of cases, landlords will be obligated to bear a substantial part of the CO_2 costs without the right to pass on these costs to the tenant.

The new allocation of CO_2 costs will primarily depend on how the relevant building is used.

I. Residential Buildings

In the bill, residential buildings are defined as buildings that, according to their intended use, predominantly serve residential purposes; residential, retirement, and nursing homes as well as similar institutions are expressly included.

For residential buildings, the allocation of CO_2 costs between landlord and tenant will generally be based on the carbon dioxide emission of the respective building. Following a 10-stage model, the landlord's cost participation obligation ranges from 90% to 0%: the lower the CO_2 emission of the building, the higher the portion of the CO_2 costs that the tenant has to bear. If the yearly emission exceeds 52 kilograms of CO_2 per square meter of residential space, the tenant has to bear only 10% of the CO_2 costs; if the yearly emission is less than 12 kilograms of CO_2 per square meter of residential space, the tenant has to bear 100% of the CO_2 costs.

According to the bill, provisions based on which the tenant must bear more than the share provided for in the graduated model are void and the landlord will not be entitled to pass on any CO_2 levies.

II. Non-Residential Buildings

For non-residential buildings (i.e., buildings that are not considered residential buildings pursuant to the definition described above), the bill contains an interim solution—provisions in lease agreements, according to which the tenant bears more than 50% of the CO_2 costs are void and the landlord will not be entitled to pass on any CO_2 levies. However, according to the explanatory memorandum attached to the bill, such a fixed 50/50 split will only be temporary—a tiered model will also be developed for non-residential buildings. The legislature intends to collect the information required for development of such a model by the end of 2024 and develop a tiered model to replace the 50/50 split by 2026.

III. Mixed-Use Buildings

The bill only distinguishes between residential and non-residential buildings. The decisive factor for a building's classification is the building's predominant use. Therefore, the 10-stage model for residential buildings would also apply to a lease agreement for a retail unit in an apartment building, while the 50/50 split for non-residential buildings would apply to a small-scale residential annex above a large discount grocery store.

Consequently, an individual analysis of a building's predominant use is necessary for every building.

IV. Reimbursement Claims of Tenants

If a tenant procures its own heat and/or hot water, the landlord must reimburse the tenant for the landlord's share in CO_2 costs. However, the tenant must submit the reimbursement claim within six months after receipt of the invoice for the supply of fuel or heat. The landlord is entitled to offset the submitted reimbursement claim as part of the annual reconciliation of service charges; if no reconciliation of services charges is owed by the landlord, the landlord must reimburse the asserted amount within 12 months.

V. Exceptions to the Allocation Principle

Pursuant to the bill, exceptions to the above principles of the allocation of CO_2 costs apply if public regulations prevent (a) significant energy improvement of the building or (b) significant improvement of the heat and hot water supply (e.g., in the case of restrictions under monument protection law, a connection and use obligation (*Anschluss- und Benutzungszwang*) regarding the supply or a preservation statute (*Erhaltungssatzung*)). If neither an energy improvement of the building nor an improvement of the heat and hot water supply is possible, no share of the CO_2 costs will be allocated to the landlord; if only one of these improvements is possible, the landlord's share is reduced by 50%.

In addition, a number of adjustments apply, including if the tenant also uses fuels to operate its own equipment for commercial or other purposes, or if the landlord does not specify the share of CO_2 costs attributable to the tenant in the service charges statement.

VI. Use of Substitute Fuels

If the landlord switches from fossil fuel to a partially biogenic fuel or hydrogen, the tenant's share of the CO_2 costs for the biogenic fuel or hydrogen will be limited to an amount equaling the basic supply tariff (*Grundversorgungstarif*) for natural gas or the then current yearly average price of the replaced fossil fuel, respectively.

VII. Outlook

Stakeholders of both landlords and tenants have criticized several points in the published bill. However, it remains to be seen whether significant changes will be made to the current draft. Given

that the new law is to become effective as of 1 January 2023 and is to apply for the first time to any settlement period commencing in 2023, we expect that the bill will be passed later this year.

New lease agreements entered into after the new law comes into force must consider the binding specifications of the new law concerning the allocation of CO_2 costs; therefore, lease agreement templates should be amended accordingly.

Lease agreements that are already in place will probably not have to be amended immediately because the draft law provides for transitional arrangements for existing leases. However, in order to avoid discussions or disagreements about the validity of existing contractual arrangements or the correctness of the service charges statements, and to facilitate the implementation of the new regulations within day-to-day administration, we consider it reasonable to adapt existing contracts to the new legal situation and recommend that this be addressed in a timely manner.

Tenants who purchase heat and hot water directly from the utility provider should set up a procedure for claiming the compensation of CO_2 costs within the abovementioned six-month period.

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If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings Frankfurt lawyers:

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[1] Draft (German language only): https://dip.bundestag.de/vorgang/gesetz-zur-aufteilung-der-kohlendioxidkosten-kohlendioxidkostenaufteilungsgesetz-co2kostaufg/288062?f.deskriptor=Klimaschutz&rows=25&pos=2.