State of Minnesota
Department of Energy and Economic Development
Energy Division

In the Matter of Proposed Permanent Rules Relating to Minimum Mandatory Energy Efficiency Standards for Residential Rental Units: Definition of Good Cause; Establishment of Fine Schedule. Minn. Rule pt. 4170.4105-4170.4110 [Emergency]

Statement of Need and Reasonableness

General Statement - Statutory Authority

The Department is proposing to adopt the above-referenced emergency rules as permanent rules without modification of the adopted emergency rule language. The promulgation of these rules is authorized by Minn. Stat., § 116J.27, subd. 4b, which requires the commissioner to adopt rules defining good cause for failure to comply with the minimum mandatory energy efficiency standards for residential rental units, set forth at Minn. Rule pt. 4170.4100, and to establish a schedule of fines for non-compliance.

Procedural History

Notice of Intent to Adopt Emergency Rules in the above-entitled matter was published in the State Register on August 27, 1984 at 9S.R. 411-412, and was mailed to all persons who had registered their names with the Department. The Notice afforded interested parties 25 days in which to submit their comments to the Department. After reviewing the comments received, the Department accepted a recommendation to amend the fine schedule portion of the rule. The rule was amended by establishing a maximum fine of $500 for a residential complex situated on one or more contiguous parcels of land under common ownership.

The Order to Adopt Emergency Rules was published in the State Register on December 10, 1984 (9S.R.1337-1339). These Emergency Rules appear at Minn. Rule pt. 4170.4105-4170.4110.

Purpose

The purpose of the "good cause" portion of the rule is twofold. First, to recognize and define those circumstances under which it would not be reasonable or cost-effective to require owners of residential rental properties to comply with one or more of the minimum energy efficiency standards. Second, to provide guidance to the administrative law judge in determining an owner's good cause for failure to comply during a contested case hearing brought by the Department.

The fine schedule is set to provide a uniform penalty for noncompliance with the standards. Minn. Stat., § 116J.27, subd. 4b states that if

the owner of a residential rental property is not able to prove a good cause for failure to comply with the standards, then the Administrative Law Judge "shall assess a fine against the owner in accordance with a schedule of fines adopted by the commissioner by rule or temporary rule."

Classes of Persons Affected

Both the good cause and fine schedule portions of this rule will have a direct impact on owners of residential rental property, and perhaps an indirect affect on tenants of such property. The rule may also affect energy evaluators (auditors) certified by the Department to certify compliance by an owner following a contested case administrative hearing.

Additionally, those municipalities or political subdivisions that have been authorized by the commissioner to conduct inspections or otherwise enforce the standards will be affected by the rule. This will be true to the extent that municipalities will be bound by the definitions of good cause.

Since tenants of rental housing will most likely not participate in the resolution of good cause arguments between their landlords and the Department, and will not be subject to the assessment of fines for noncompliance, this rule will not affect them directly.

Department-certified evaluators will be affected by the rule only to the extent that they may be employed by building owners to certify compliance following a finding of noncompliance by an administrative law judge.

As to whether there are less costly or intrusive methods of achieving the purpose of the proposed rules, the basic thrust of the rules is to mitigate the costs of the energy standards by allowing for good cause exemptions. These rules also provide guidance for an expedited enforcement process through the Office of Administrative Hearings, a process that will allow contested cases to be brought for hearing in one month, as opposed to the much lengthier process through district court. It was important in setting the fine schedule to weigh the costs of complying with the standards against the proposed penalty for noncompliance. Building owners can not be encouraged to accept fines as a less expensive option to meeting the minimum standards. When viewed in this light, the fine schedule should provide the necessary incentives to comply without being overly severe.

Anticipated Consequences

In general, the Department anticipates that the proposed rules will help further the goal of saving energy in residential rental buildings. This result will derive from the establishment of guidelines for cost-effectiveness and reasonableness (i.e. good cause provisions), and incentives for meeting the minimum energy efficiency standards in the form of a fine for noncompliance (i.e. fine schedule). Together, these provisions will promote compliance with the standards, thus improving the overall energy efficiency of the state's rental housing stock.

One result of the good cause portion of the rule will be the constant re-examination of the reasonableness and cost effectiveness of the current standards. The Department's experience may lead to the revision or elimination of particular standards or cost savings calculation procedures. The Department may also decide to conduct further research into particular areas of conservation retrofit technology. Such research could lead to improvements in our state-of-the-art understanding of what works and what does not work in multi-family residential structures.

As to the fine schedule portion of the rule, the Department plans to pursue legal remedies only in cases of clearly documented noncompliance and failure to take steps towards compliance; it is our hope that very few building owners will need to be fined. It is difficult to predict how many building owners will be fined in a given time period since this will be dependent on the types of cases we receive and the volume of cases that can be realistically pursued given limitations on Department staff resources, Attorney General's Office support, and the Administrative Hearing Office's caseload.

It should be clear, though, that the adoption of a fine schedule is an expression of the Department's committment to requiring compliance with the standards. The fact that the fine is doubled and assessed monthly after an initial fine and a reasonable period of time to comply, is an indication that noncompliance will not be tolerated indefinitely without penalty. It should also be understood that the adoption of the proposed fine schedule in no way limits the Department's ability to seek more severe civil or criminal sanctions pursuant to Minn. Stat. sect. 116J.30 when deemed necessary.

Impact on Small Business

Minnesota Statutes § 14.115, subd. 2, requires an agency proposing new rules to consider the impact those rules would have on small businesses. The statute requires the agency to consider methods of reducing the impact of the rule by a variety of methods, including less stringent compliance or reporting requirements, less stringent schedules, simplification of compliance requirements, the establishment of performance standards to replace design standards, or total exemption from the rule's requirements.

Although the statute only requires the Department to consider the impact on small businesses, it is apparent to the Agency that data are not available which indicate the financial worth of rental property owners. However, it is the belief of the Department that the majority of the landlords whose rental units are covered by the statute would be included under the definition of a small business. Since almost half of Minnesota's rental housing stock is comprised of buildings with 4 units or less, it is likely that most owners would be defined as a small business operation with 50 or fewer employees, or gross annual sales less than $4 million.

It is the Department's position that the proposed rule is essential to effectively implement legislative intent. With the 1982 addition of subdivision 4b. to Minnesota Statute § 116J.27, the legislature clearly

required the Commissioner to adopt rules defining good cause and establishing a schedule of fines. The proposed rules answer both of these legislative directives.

Minnesota Statutes § 14.115, subd. 2 (a) calls for an agency to consider the establishment of less stringent compliance or reporting requirements for small businesses. It is difficult to see how this provision applies to the good cause portion of the rule since these define exceptions to compliance with a rule rather than requiring compliance, per se. This provision has been considered, however, in the establishment of the fine schedule. The schedule calls for significantly smaller fines for owners of one to four unit rental properties; in most cases, fines for these smaller buildings will be one fifth the size of fines for larger buildings. And since, as noted above, owners of smaller buildings may also be considered small business owners, the proposed rule does call for a less stringent fine for small businesses.

The proposed rule does not provide for mandatory reporting requirements, so consideration of less stringent provisions for reporting was not necessary.

Subdivision 2 (b) calls for less stringent schedules or deadlines for small businesses. Again, to the extent that the fine schedule is a schedule of sorts, and for the reasons noted above, the proposed rule does call for a less stringent schedule for owners of small businesses. However, the rule does not call for the meeting of time schedules or deadlines and so consideration of this provision was not necessary. The fine schedule does provide for periods of time after which fines are doubled and assessed monthly. These time periods vary from 120 days for one to four unit buildings, and 180 days for 5 unit or larger buildings. Although this may seem to be a more stringent "schedule" for smaller buildings (and thus small businesses), the rationale for varying time schedules is that owners of larger buildings may have more difficulty in finding and employing contractors capable of performing work in larger structures. This issue will be addressed in more detail in the need and reasonableness section to follow.

Subdivision 2(c) asks the agency to consider ways of consolidating or simplifying compliance or reporting requirements. Again, the proposed rule does not contemplate these issues, but rather provides for exemptions from compliance and fines for non-compliance. To the extent possible, though, this rule is simple and straightforward in providing guidance to affected persons as to its implementation.

The rule also does not contemplate any design or operational standards and so to propose an alternative performance standard for small businesses, as suggested under subdivision 2 (d), would not be appropriate.

Subdivision 2(e) requires consideration of exemption of small business owners from the rule. To exempt this class (or any other class) of rental housing owners from the good cause portion of the rule would clearly be a disservice since this portion spells out the only opportunities for exemptions from the standards. As to an exemption from the fine schedule, the legislature established its clear intent that rental housing

be made more energy efficient through the adoption of minimum energy efficiency standards and enforcement powers. This enforcement authority clearly includes the power to seek the levy of fines for noncompliance through the administrative hearings process. The Department therefore has no authority to exempt owners of rental housing from the penalties for non-compliance as set forth in the proposed fine schedule. Instead, the Department has proposed a variable fine schedule which provides for a smaller fine for owners of small buildings, the majority of whom the Department believes are small business operators.

Need and Reasonableness

Each section of the proposed rule will be cited in bold face. Following each citation, the Department will explain the need and reasonableness of that section.

MN Rule pt. 4170.4105 GOOD CAUSE

As required by Laws of Minnesota 1984, Chapter 595, section 4, "good cause" means any one of the following:

This sentence simply cites the statutory authority for the promulgation of rules defining good cause.

The proposed rule defines three good cause categories, any one of which a building owner may exercize in his/her defense of noncompliance with a particular standard. Again, these good cause categories define those circumstances under which it would not be reasonable or cost effective to require a standard (or standards) to be met. The rule is also needed to provide guidance to the Office of Administrative Hearings in determining good cause during a contested case hearing.

A. That the installation of a program measure to comply with a standard in part 4170.4100 is economically infeasible as defined in part 4170.0100, subpart 8.

This section follows the legislative directive that the minimum standards be economically feasible, meaning that energy savings which result from the implementation of these standards "will exceed the cost of the energy conserving requirements amortized over the ten-year period subsequent to the incurring of the cost" (M.S. § 116J.27, subd. 1). In general, this means that where the cost of making an energy related improvement, otherwise required by law, does not have a "simple payback" (i.e. cost of installation amortized) of ten years, that improvement will not be required. Improvements required by law are set forth at Minn. Rule pt. 4170.4100 (cited throughout this part of the rule) where the minimum standards for rental housing are enumerated.

Economic feasibility is defined by rule at Minn. Rule pt. 4170.0100, subpart 8, to wit:

> For the purpose of these rules, the test of economic feasibility is met when the savings in energy procurement costs, based on residential energy costs as certified by the commissioner in the State Register, or on local fuel costs, exceed the cost

of acquiring and installing each standard as amortized over the subsequent ten-year period. The costs of acquiring and installing each standard may include the costs of restoring the building to the condition that existed immediately before the standard was installed, costs to install a vapor barrier where determined necessary, and displacement costs of temporary tenant relocation where determined necessary.

This reference speaks to several issues. First, "energy procurement costs" (i.e. fuel bills) will be based on standardized average costs of fuel reported statewide or on local fuel costs. Second, that the costs of "acquiring and installing" (i.e. materials and labor) can include certain costs beyond strict materials and labor costs for the improvement in question. The costs of restoring a building to its original condition, of installing a vapor barrier and of tenant relocation during construction may be included in the payback analysis. It is reasonable to assume that in some instances, including such costs will drive the payback for that particular standard over the ten year limit, thereby removing that standard as a requirement. This definition of economic feasibility is reasonable in that it provides a uniform basis for determining cost-effectiveness while allowing certain unforeseen yet necessary costs to be included in the payback calculation.

The calculation procedures which the Department will use to estimate paybacks are established in rule at Minn. Rule 4170.9920. These procedures allow for the actual derivation of payback periods by taking into account the costs and quantities of energy saved, heat losses before and after improvements are made, and adjustments for changes in weather conditions from year to year. These calculation procedures represent the latest methods for determining energy savings for a wide variety of conservation measures.

B. That the installation of a program measure to comply with a standard in part 4170.4100 is technologically infeasible. Technological infeasibility means that the installation of the measure would threaten the structural integrity of the building.

This section, dealing with technological feasibility, is intended (as are all three good cause categories) to provide relief for building owners from unreasonable, or in this case, structurally unsafe requirements. Given the nature of the required improvements, it is the Department's contention that there will be very few instances in which requiring a program measure would "threaten the structural integrity of the building." In most cases, a knowledgeable contractor will be aware of the appropriate installation techniques to avoid the potentital for structural damage. Such precautions would include the installation of a vapor barrier when insulating a wall or foundation wall, ventilation devices designed to avoid moisture buildup when insulating an attic and repair of a damaged or leaky roof before adding attic insulation. It is expected that contractors engaged to perform work to meet the standards will be experienced in the field, and licensed and bonded for the type of work being performed.

There will be cases, however, in which the installation of a particular program measure would not be advisable and therefore not required as

a condition of full compliance with the law. Some examples of possible cases of technologically infeasible measures and building types may include, but are not limited to:

1. Flat-roofed buildings with common joists for the ceiling and roof. Such attic structures are at present very difficult to insulate by any conventional means (i.e., drilling the attic cavities and blowing in insulation), and are also problematic due to the difficulty in ventilating the attic properly after insulation.

2. Stone and mortar foundation walls. Because these walls do not provide a reasonably flat surface to apply rigid insulation to, and because the spray-on urethane products are, as yet, an unproven alternative to the conventional insulation strategy, it is not reasonable, in most cases, to require insulation of these foundation walls.

3. Interior foundation wall insulation in certain soil/moisture type situations. There is some anectotal evidence collected from contractors around the State which suggests that interior insulation in some cases can lead to moisture and frost heave problems in certain clay soil types or where good water drainage away from the foundation wall is not possible.

4. Double brick walls with an uninsulated cavity. In most cases, if there is a cavity between the two layers of brick, the cavity is generally very small and inconsistent in dimension. Drilling these walls to insulate them is, in most cases, not recommended for these reasons.

This is not intended as an exhaustive list of technologically infeasible situations,and the cases cited above may not constitute grounds for exemptions under this section in a specific case. For these reasons, the Department has not included specific exemptions under this section in rule language. Given that our base of understanding of technological issues related to conservation retrofitting is expanding, alternative installation strategies may be found to resolve these issues over the course of the program.

C. That the installation of a program measure to comply with a standard in part 4170.4100 would necessarily violate the buildings esthetic or historic value.

This section, as with the previous two, exists to mitigate the effect of the standards where they would otherwise be unreasonable or not cost effective. In this case, owners of buildings which have a particular esthetic and historic value may seek an exemption from a standard because the installation of that standard would, in some way, irreparably damage those historic or esthetic qualities. At this point, the Department is not aware of specific examples of how such damage may occur. However, the Department recognizes that in some situations it may be difficult

or impossible to restore a building component to its exact or similar condition after installation as provided for by Minn. Rule pt. 4170.0100, subpart 8.

Although broadly defined, types of buildings which may be considered for exemptions under this category include those buildings on a historic register (i.e., national, state or local register), those buildings within a historic preservation district as designated by a governing body, or those buildings with clear historic or esthetic significance or qualities. In the case of buildings on a historic register or in a historic preservation district, certain construction or modification restrictions may apply which would prevent the installation of program measures. Where this is the case, it is expected that the building owner will submit documentation to this effect with his/her application for an exemption. Again, the Department does not consider it an obligation to define all of the possible cases where this category of exemption may apply.

MN RULE pt. 4170.4110 Fine Schedule

If an administrative law judge finds that an owner or an owner's agent has not demonstrated good cause for failure to comply with the minimum mandatory energy efficiency standards, the judge shall assess the following penalties:

The fine schedule portion of the rule sets out a uniform, mandatory schedule of fines for noncompliance with the standards. The first paragraph of this section makes it clear that when, in the course of a contested case administrative hearing, an owner or owner's agent has been unable to prove a good cause for non-compliance, the administrative law judge will assess penalties (fines) in accordance with the fine schedule. The reference to "an owner's agent" could mean anyone the owner chooses to represent him/her in the case including his/her attorney, property manager or caretaker, or licensed professional engineer.

It is the Department's contention that there is a need and reasonableness for a uniform and mandatory fine schedule. First, such a schedule is required by statute (see Minn. Stat. § 116J.27, subd. 4b). Second, the schedule needs to be uniform across building size graduations (i.e., 1-4 units and 5 or more units) so that owners of like rental dwellings are treated similarly and equitably. Third, the fine needs to be mandatory (i.e. in cases of failure to prove good cause) in order to assure that penalties will be assessed against noncompliant owners. Without this requirement, some administrative law judges may be inclined to simply warn an owner without penalty, or vary the fine schedule based on some arbitrary set of criteria. Finally, it is important as an incentive that all rental housing owners are aware that there are mandatory fines for non-compliance. The Department expects that this awareness will encourage voluntary compliance among owners who are "waiting to see" if the Department is serious about enforcing the standards.

A. For a one-to-four unit building, an immediate fine of $100 plus $200 each month beginning 120 days after the finding of failure to show good cause, until the owner demonstrates to the administrative law judge that she or he has complied with the standards. If a person certified under chapter 4170 to conduct evaluations certifies that an owner complies

with the applicable standards, the judge shall consider the certification as proof of compliance by the owner.

This proposed section of the rule establishes the schedule of fines for one-to-four unit rental buildings.

Two types of rental housing are specified in the fine schedule--one-to-four unit buildings, and five-plus unit buildings. These categories were chosen to correspond with the building size breakdowns contemplated by the energy efficiency standards. These categories also reflect standard industry practice for delineating smaller and larger rental building types.

The fine schedule for one-to-four unit buildings calls for an immediate fine of one hundred dollars. As with the other fine schedule amounts, the $100 initial fine is not based on any other schedule of fines, however, this amount does seem to be consistent with minimum penalties set for minor misdemeanor violations of all types. Especially in the case of the initial fine, the penalty is intended to motivate the building owner to comply before larger penalties are imposed. At the same time, the penalty is not so large that the owner's resources have been depleted to the point where he/she can no longer afford the required improvements.

Following a judgment of noncompliance and failure to show good cause, owners of 1-4 unit buildings will have 120 days in which to make the required improvements and present proof of compliance to the administrative law judge. If proof of compliance is not presented by this time the administrative law judge will order that the fine be doubled to two hundred dollars, and assessed monthly until compliance is demonstrated. This escalation of penalties is seen by the Department as a necessary vehicle for assuring compliance in cases involving highly recalcitrant owners. However, it seems likely that following a negative finding by a law judge and an initial $100 fine, most owners will begin taking the necessary steps towards compliance. Thus, an owner who argues that he/she has a good cause, but fails to persuade the administrative law judge, has a reasonable amount of time to make the necessary improvements.

The demonstration of compliance following a contested case hearing can take place in two ways. When an owner feels that the required improvements have been completed, he/she can either contact the compliance officer with the Department who had made the initial determination of noncompliance, or contact a DEED-certified auditor if she/he prefers an independent inspection for compliance. It is reasonable to include an independent compliance certification process following a contested case hearing since an adversarial relationship may have developed between a building owner and the Department.

B. For a building of five or more units, an immediate fine of the greater of $10 per unit or $100, up to a maximum of $500. The maximum fine of $500 is also the maximum fine for a residential complex situated on one or more contiguous parcels of land under common ownership. In addition, a fine each month of two times the amount assessed beginning 180 days after the finding of failure to show good cause, until the owner demonstrates to the administrative law judge that she or he has complied

with the standards. If a person certified under chapter 4170 to conduct evaluations certifies that an owner complies with the applicable standards, the judge shall consider the certification as proof of compliance by the owner.

The fine schedule for buildings of five or more units is somewhat different from the schedule for one-to-four unit buildings. The initial fine is bounded by a range of minimum and maximum fine amounts dependent on the number of units in the building rather than a flat amount for every building. The minimum fine is $100 regardless of the number of units. For buildings with ten to fifty units the fine is based on $10 per unit; the maximum initial fine for buildings with fifty or more units is $500. This variable schedule recognizes the wide variation in building sizes in the five-plus-unit category while establishing a reasonable maximum penalty for non-compliance. As with the schedule for one-to-four unit buildings, this schedule will encourage compliance following a contested case hearing while not unnecessarily depleting the resources to gain full compliance.

The establishment of $500 as the maximum fine against a "complex situated on one or more contiguous parcels of land under common ownership" is an amendment to the emergency rule suggested by Mr. John Horner of the Minnesota Multi-Housing Associtaion. The suggestion by Mr. Horner clarifies an ambiguity in the proposed rule regarding the applicability of the maximum fine against a building, or a number of buildings in a complex. It is the Department's contention that the initial maximum penalty of $500 and $1000 per month after 180 days will motivate the owners of even the largest complex to make the improvements required to comply with the standards. Setting the maximum fine against a complex eliminates an inequity that would otherwise exist between a large building and a series of smaller ones, all under common ownership.

The fine against an owner who does not comply after a contested case hearing, in this case within 180 days of the hearing, is doubled and assessed monthly. Owners of five-plus-unit buildings are given 60 more days (i.e., 180 rather than 120 days) than owners of one-to-four unit buildings. It is the Department's belief that owners of larger buildings will need extra time to arrange for bids, to hire contractors, and to get the work completed, than will owners of smaller buildings. This will be especially true in large multi-building complexes or multi-story high-rise buildings. Six months, however, is a reasonable amount of time in which to expect full compliance.

The two methods for confirming compliance following a contested case hearing (i.e., DEED staff compliance officer or DEED-certified evaluator certifications) are also available to owners of five-plus-unit buildings.

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STATE OF MINNESOTA
DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

In the Matter of the Proposed Adoption of Rules of the State Department of Energy and Economic Development Governing Minimum Mandatory Energy Efficiency Standards for Residential Rental Units: Definition of Good Cause; Establishment of Fine Schedule

STATEMENT OF COMPLIANCE WITH RULEMAKING PROCEDURES

I, Thomas F. Pursell, do hereby declare that I have examined the rules and all related documents and that, based on my examination and my personal familiarity with the applicable procedures, the Administrative Procedure Act, the rules of Administrative Hearings and the rules of the Attorney General have been followed. Any exceptions are noted below.

Dated: June 25, 1985

Thomas F. Pursell
Special Assistant
Attorney General