

LANDOWNER GUIDELINES FOR EVALUATING WIND ENERGY PRODUCTION LEASES

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The process of evaluating a wind lease can be complex, and the signing of such a lease involves a long-term commitment by the landowner. Leases can be as short as a few pages or as long as a hundred pages. As a general rule, longer lease documents provide more detailed responsibilities for the leasing parties and are more likely to provide specific answers for disputes that arise in the future. It is also important to note that nearly all leases are option agreements and do not guarantee that wind energy will be developed on the property. A modest fee (\$5 to 10 per acre) is paid for the option of developing the property for wind energy generation. Whether this option is exercised will depend upon a number of factors (e.g., adequacy of the wind resource, electricity prices, proximity to the electrical grid, local regulations, etc.)

This worksheet is designed to help landowners consider some important issues that should be addressed in a lease and some of the alternatives to address those issues. This worksheet is divided into sections related to key issues in wind energy contracts. Where appropriate there are comments to help you understand some alternatives to consider for each issue. It is strongly advised that you obtain legal assistance to better understand the provisions presented in the lease. **This worksheet is not a substitute for obtaining legal counsel regarding the lease – it is intended to help focus your discussions with qualified legal counsel.**

I. Basic Details of the Lease

Name of leasing agent/company _____

Description of land parcel(s) and portions of parcels to be leased _____

Contract person/company _____

II. Introductory Issues

A. What are your long-term (25 to 35 years) plans for the land parcel(s) covered by the lease?

- | | |
|---|--|
| <input type="checkbox"/> Retain in farming | <input type="checkbox"/> Commercial development |
| <input type="checkbox"/> Recreational use (e.g., hunting) | <input type="checkbox"/> Keep as “natural” as possible |
| <input type="checkbox"/> Sell to others | <input type="checkbox"/> Other _____ |

Wind energy leases are long-term agreements, with the shortest in length being 20 to 25 years and the longest as much as 99 years. If you or your heirs have plans to use these parcels for another purpose during the life of the lease, you may be prevented from doing so by the lease or because the parcel is less desirable for the purpose you envision in the future.

B. To what degree will the lease payments help or hinder your plans or goals?

- | | |
|--|---|
| <input type="checkbox"/> Very important for plans or goals | <input type="checkbox"/> Somewhat hinders plans or goals |
| <input type="checkbox"/> Somewhat important for plans or goals | <input type="checkbox"/> Significantly hinders plans or goals |
| <input type="checkbox"/> Limited importance for plans or goals | <input type="checkbox"/> Neither helps nor hinders plans or goals |

The lease payment might help achieve your plans or goals and will likely affect your financial options in the

future. If the lease payments help achieve your financial objectives, then the lease might be useful in meeting your future goals. On the other hand, if the lease prevents your use of the property for other purposes, then the lease may hinder your longer term goals or plans.

C. Who is offering the lease?

- | | |
|--|---|
| <input type="checkbox"/> A leasing agent | <input type="checkbox"/> A community wind project |
| <input type="checkbox"/> A Michigan wind energy developer | <input type="checkbox"/> An out-of-state wind energy firm |
| <input type="checkbox"/> An international wind energy firm | <input type="checkbox"/> Other _____ |

There are many firms offering wind energy leases. Some firms assemble leases for a block of land that could be developed into a wind farm and then sell the leases to a wind developer for a fee. Another firm may offer leases and intends to develop the wind project itself. Other issues to consider are: Does the firm have prior experience in developing wind projects and, if not, is there a good chance they will succeed with the project? Would you prefer to have a lease with a community-based project, a local firm, or a firm located in a foreign country? Regardless of who originally offers the lease, there may be an assignment clause in the lease. Be sure to see section IV below for details about assignment clauses. In addition, if you are dealing with a firm from outside Michigan, see section IX below for details about the legal ramifications of dealing with an out-of-state firm.

D. Does the lease have a confidentiality clause?

- Yes No

Many legal analysts advise against signing a lease containing a confidentiality clause. This clause may prevent discussion of the lease with other landowners involved in the project and may inhibit family communications.

III. Length of the Lease

A lease can have two or three time periods: 1) an evaluation phase, 2) a production phase, and 3) an option for extension of the production phase. The sum of these phases can be quite long. Be aware of the length of each phase and the total time commitment for your property under the lease.

A. Evaluation or discovery phase

1. What is the time permitted for the evaluation phase? _____ Years
2. If the developer is permitted to extend the evaluation phase, how long is the extension? _____ Years

In the evaluation phase, the developer will collect information about wind quality and conduct an economic analysis to determine the viability of the project. In some cases, the contract will permit the evaluation phase to be extended by the developer. It is usually desirable for the landowner to keep this phase as short as possible. With a long evaluation phase, a developer can control the property for several years while waiting for the project's viability to improve (e.g., easier access to the electricity grid, finding financial resources, higher electricity prices). During this time, you would not be permitted to sign a contract with another developer who has more immediate plans to develop the property. Note: This issue is of such critical importance that some states (e.g., South Dakota) have limited the phase to 5 or 7 years by law. Michigan has no such law and the parties must resolve this issue in the lease.

B. Production phase.

1. What is the length of the production phase? _____ Years

The length of the production phase in the lease is usually 20 to 30 years. A long production phase is necessary because the investment has a long payback period. Usually, a shorter phase is desired because this provides an earlier opportunity for the landowner renegotiate the terms of the lease or use the land for other purposes.

C. Renewal or extension of the production phase

1. What is the length of time the production phase may be extended by the developer? _____ Years

Some developers claim that an extension clause is necessary to obtain financing for the project. Most wind projects, however, have financing terms of 12 to 15 years, well within the range of the initial production phase. Consider the following issues if faced with this decision: What land use decisions might you, your heirs, or a buyer want to make? Will the lease payments be sufficient 30 years from now? It is generally in the landowner's

best interest to be able to renegotiate the terms of the lease before it is renewed, or to be able to terminate the agreement at the end of the lease. By avoiding an automatic extension clause, you might be able to protect your future land use options. If the developer seeks an extension clause, then additional financial compensation should be negotiated.

D. Total lease period

To determine the maximum time the parcel will be committed to the lease, add the following:

Evaluation Phase (A.1) _____ + Evaluation Phase Extension (A.2) _____ + Production Phase (B.1) _____ + Production Phase Extension (C.1) = _____ Total Years Committed

IV. Compensation Clauses

Because there are many payment options, the determination of the compensation clause is a difficult issue in any lease for wind energy development. Careful attention must be paid to the payment method's impact on the landowner's returns for the entire length of the lease.

A. What is the payment being offered during the evaluation phase of the lease? _____\$/Acre
This payment is offered for the option of developing the parcel for production of electricity from wind. Be aware that a firm offering a higher payment does not imply that the firm is more committed to actually developing the property for wind energy. Thus, do not become too concerned with this payment – instead, focus on the payments during the production phase for the lease. Production payments are much more critical in determining the landowner's long-run returns from the project.

B. What method is used to determine payments for the electricity generated during the production phase of the lease?

- | | |
|---|--|
| <input type="checkbox"/> A lump-sum payment at the beginning of the lease (\$_____) | <input type="checkbox"/> An annual fixed payment per turbine (\$_____) |
| <input type="checkbox"/> A payment based on a percentage of the electricity sales (____%) | <input type="checkbox"/> A payment based on an annual fixed payment <u>and</u> a percentage of the electricity sales (\$ _____ annually and ____%) |
| <input type="checkbox"/> Other_____ | |

If the lease offers a lump-sum payment at the beginning of the lease, then this payment will be the only payment you will receive during the life of the lease. There might be situations in which having access to an immediate payment is desirable, but care must be taken with this option. What are the tax consequences of a lump-sum payment? How does it compare to a lease with payments over time? To compare the options, use a standard financial annuity formula to convert the lump-sum payment into annual payments. It is important to make this calculation so you are fully informed about your decision.

The option of a fixed payment per turbine guarantees the landowner's payment regardless of how much electricity is generated. Thus, the developer will bear the risk related to variations in the electricity generated. At the same time, you will receive this payment only if the project is actually developed. With this option, it is important to know the size of the turbine because the payment offered should be higher for larger turbines.

Another option is for the lease to share a percentage of the electricity sales with the landowner. Thus, returns can vary based on variations in wind speed and the landowner will share in the risk associated with the quantity of electricity produced. To obtain an estimate of the payment received under this lease, obtain the following information about the Power Purchase Agreement (PPA) that the developer has negotiated with the electricity buyer (the electricity generated is usually measured at the connection to the grid or at the turbine site):

- *The electricity sale rate (Dollars per kilowatt-hour);*
- *An estimate of the annual kilowatt-hours of electricity generated per turbine at the point where the power is measured (this will be affected by the quality of the wind resource and the size and type of turbine installed);*

· Your percentage share of the electricity sales specified by the lease.

By multiplying these three estimates, you can calculate your estimated annual returns per turbine. With this payment option, there could be many unknowns because the PPA, the wind resource strength, and the type of turbine to be installed might not be known at the time of the signing of the lease.

C. How many turbines will be installed on your property? _____

For leases offering a fixed payment per turbine or a percentage of electricity sales, it is necessary to estimate the number of turbines to be installed on your property. This payment will vary by the size of turbine installed. With larger turbines, the payment per turbine should probably be larger. The number of turbines multiplied by the expected annual payment per turbine will equal the total annual payment.

D. Will “pooling” be used to calculate the value of electricity sales?

Yes No

This procedure might be used if the lease payment is based on a percentage of the electricity sales. If pooling is used, then your returns will be based on your share of the acreage in the project. If you own 10% of the total acreage in the project, then your share would be 10% of the electricity sales from all the turbines in the project, even if you had more or less than 10% of the turbines on your property.

E. Does the compensation clause include the sale of the Renewable Energy Credits (RECs)?

Yes No

Electricity from renewable energy projects (including wind) has two sources of value: 1) the value of the electricity generated (Dollars per kilowatt hour) and 2) the value of the Renewable Energy Credits (RECs). When negotiating the PPA, the developer might sell both the electricity and the RECs, or the developer might sell only the electricity, with the RECs being sold to another buyer. In either case, does the lease share the value of the RECs with the landowner? How will the value of the RECs be determined? The value of the RECs is expected to increase in the future as the states or the federal government enact Renewable Portfolio Standards or new regulations on climate change issues.

F. Does the compensation clause have an inflation adjustment provision?

Yes No

Because of inflation, a dollar ten years from now will have less value than a dollar today. It is desirable, therefore, to have a compensation agreement that increases your payment to adjust for inflation at specific intervals (e.g., annually or every five years). The developer is likely to have an inflation adjustment included in the PPA with the utility. Therefore, the landowner should request an inflation adjustment clause to protect the value of future payments. Otherwise, the inflation-adjusted value of your payment will diminish significantly over the 20 to 30 year life of the lease.

G. Does the compensation clause include payment for the land removed from existing uses by the developer (such as permanent roadways or structures) during the production phase?

Yes No

During the production phase, the developer must have access to the turbines and may need to construct other structures on the land. The lease should specify the landowner’s payment per acre for the use of this land.

H. Does the compensation clause include payment for the land used by the developer during the construction phase, such as temporary roadways, temporary structures, space for large equipment such as cranes, etc.?

Yes No

During the construction phase, the developer might need access to land on a temporary basis. If such use interferes existing with uses of the land (e.g., prevents the planting of a crop or destroys an existing crop), the lease should specify the landowner’s payment per acre for the use of this land during this phase. In addition, the lease should specify that land used on a temporary basis will be returned to its original state by the developer before the construction is concluded.

I. Does the lease contain a Force Majure clause?

- Yes No

A Force Majure clause permits the developer to extend the time of the lease if a delay is caused by any law, legal action, or requirement of a government agency, court, or utility. The clause might also apply to natural causes that prevent the development or use of the project. During the time this clause is in effect, any payment due to you could be delayed or avoided by the developer. These clauses are common in oil and gas leases.

IV. Assignment Clauses

A. Does the lease have an assignment clause?

- Yes No

An assignment clause permits the wind developer to sell/transfer the lease rights to another party. Thus, a lease with this clause might mean that a different company will own the rights to the lease in the future. If the lease has an assignment clause, you may want to consider at least two options. First, you may want to negotiate a higher payment rate as compensation for the risk you face in dealing with another party in the future. Second, you may want to negotiate a provision in which the developer is liable if the lease is assigned to a third party and the third party fails to satisfy the terms of the lease (especially the payment terms). In a similar matter, does the lease permit the developer to mortgage the leased property to a third party without the landowner's permission? If the developer mortgages the property under lease to a third party, and the developer then defaults to the third party, the landowner's rights relative to the developer and the third party might be affected. A lease should specify the conditions under which a mortgage may be exercised by the developer and the landowner's right of approval in such a case. In addition, the lease should limit the landowner's obligations to the third party.

VI. Property Taxes

A. Does the lease specify who will pay the property taxes associated with turbine(s), other equipment, or any other improvements on the property?

- Developer Landowner

The turbine(s) and any other associated improvements are likely to be considered improvements in the property and therefore subject to property tax. In some cases, contracts specify that the developer is liable for the property taxes associated with the wind project. If the landowner is to be liable for such tax increases, the compensation received by the landowner should reflect such an expense.

VII. Liability Issues

A. Who will be responsible for liability coverage?

- Developer Landowner

At least four potential liability issues should be considered in the negotiation of a lease. First, the liability of the landowner for damage he/she commits on the turbine and other facilities on the property is a major issue that should be specified in the lease. Be aware that the landowner also might be liable for damages caused by a third party whom the landowner grants permission to use the property. For example, assume the landowner gives permission for a third party to hunt on the land. If the hunter damages a turbine, is the landowner liable for those damages? Second, is the developer liable for damages to the landowner's property at each phase (evaluation, construction, production) of the lease? Third, is the developer liable for damages that occur to a third party? For example, assume a third party is injured by ice that falls from the blades of a wind turbine. Is the developer or the landowner liable for the third party's injuries? Fourth, does the lease require the developer to carry insurance on the turbine and associated facilities? In addition to consultation with an attorney, the landowner should have the contract reviewed by his/her insurance agent.

B. Who will pay the cost of any litigation with a third party?

- Developer Landowner

Litigation with a third party can arise in many situations. For example, assume a neighbor, claiming to be affected by the noise of the turbine, sues to halt the operation of the turbine. Will the cost of responding to that lawsuit be borne by the developer or the landowner? The lease should specify which party will pay the cost of such events.

VIII. Other Restrictions on Land Use

A. Does the lease contain other restrictions (e.g., a prohibition of hunting) that prevent the landowner from using the property for other desirable purposes?

Yes No

The lease may contain provisions that limit the landowner's use of the land. At the very least, the lease is likely to limit the height or location of building construction near the turbine(s), the height of trees or other obstructions near the turbine(s), and other activities that could interfere with the operation of the turbine(s). While some provisions are necessary to permit the efficient operation of the turbine(s), landowners should be sure that such clauses are narrowly written to prevent interference with other activities on the property.

B. Who will pay the cost (e.g., fines, etc.) for violations of land use regulations caused by the project?

Developer Landowner

Wind projects can be subject to many local land use and zoning regulations (e.g., setback regulations). If the project violates a regulation, and a fine or other penalty must be paid, which party will be liable for such a violation? The lease should specify (a) each party's responsibility in complying with such regulations during the life of the lease and (b) each party's responsibility in the case of violations of such regulations.

C. Is the turbine or an associated structure located on land enrolled in the Conservation Reserve Program (CRP)?

Yes No

Wind turbines may be placed on land enrolled in the CRP, but such projects must be approved by USDA as "consistent with the conservation of soil, water quality, and wildlife habitat." Landowners should consult with the Farm Service Agency and/or the Natural Resources Conservation Service regarding the placement of turbines or other structures on CRP acreage. The lease should also specify which party is liable for any penalties or fines imposed for violations of CRP regulations.

D. Is the turbine or an associated structure located on land enrolled in USDA commodity programs (i.e., on Crop Acreage Base)?

Yes No

If the turbine or other facilities are located on land that is enrolled in USDA commodity programs, how will the developer's use of that land affect the landowner's farm program payments? Does the lease payment received by the landowner justify the loss of commodity program payments? Landowners should consult with the Farm Service Agency to determine the impact of the developer's use of the land on commodity program payments.

IX. Choice of Law/Choice of Venue Clauses

A. Does the lease contain a choice of law clause or choice of venue clause?

Yes No

If you are considering a lease with a developer from outside Michigan, you should examine the lease for both a choice of law clause and a choice of venue clause. A choice of law clause might specify that any litigation that arises under the contract must apply the laws of the state in which the developer is located. While the dispute might be heard in a Michigan court, the court would be required to apply the laws of the developer's home state. If the lease contains a choice of venue clause, the case would be heard by a court in the developer's home state. It is usually in the landowner's best interest to have all legal disputes resolved under Michigan law by a

Michigan court.

X. Termination of the Lease

A. Does the lease specify the events that permit the developer to terminate the contract?

- Yes No

A particularly important issue is whether the developer is permitted to terminate the contract “at any time without cause.” If so, what are the landowner’s rights to any remaining payments under the contract?

B. Does the lease specify the landowner’s rights of termination?

- Yes No

Particular attention should be paid to how the landowner must exercise the right of termination (including the issue of whether arbitration – including binding arbitration – is required).

C. Is the process defined for the removal of the turbine and associated facilities (i.e., structures, roads) at the conclusion of the lease?

- Yes No

D. Who must pay the costs associated with the removal of the turbine and facilities at the conclusion of the lease?

- Developer Landowner

The cost of installing and removing a wind turbine can be substantial. The lease should specify which party will pay the costs of removing the turbine and associated facilities when the lease is terminated. Some leases require the developer to pay these costs and to retain funds in escrow that will be sufficient to pay these costs. The lease should also specify the condition of the land at the end of the removal/clean up process.

XI. Other issues related to the lease

There are many more issues that should be considered in negotiating a lease for electricity production from wind. Only the assistance of competent legal counsel can address the full list of issues that should be considered in such a lease. The following is a partial list of other issues that should be considered.

A. Does the lease grant broad access and use of the land parcel to the developer? In general, such provisions should be narrowly written to limit the use of the land to those portions necessary for the conduct of the project.

B. Is the landowner an LLC or other form of business organization other than a sole proprietorship? Michigan contract law might treat contracts between an LLC and a developer in a different manner than discussed here.

C. Does the lease grant a perpetual easement to the developer for the use of the land? Such provisions are usually considered unfavorable to a landowner.

D. Does the lease address the issue of default during the project? What are the landowner’s rights if the developer defaults, leaving an unfinished project?

E. Does the lease require that disputes be submitted to mediation or arbitration before a lawsuit can be filed? If so, what is the mediation/arbitration process?

F. Does the lease include any other form of mineral rights or property rights? If the lease includes any other form of property rights, be sure that the lease includes compensation for the purchase of other rights.

- G. Does the lease specify which party will be responsible for the enforcement of trespassing laws and the actions of trespassers?
- H. Does the lease require bonding by either party during the project?
- I. In the event of a change in a law or regulation that invalidates one portion of the lease, does the remainder of the lease apply as written?
- J. Does the lease require the developer to include the landowner on the developer's insurance policy?

XII. Conclusion

The development of electricity generated from wind has the potential to be a viable industry in Michigan. To participate in this industry, landowners should be aware of the economic benefits and the potential legal risks associated with negotiating a contract for the generation of electricity from wind. Above all, landowners should be aware that signing a wind contract should be a matter of negotiation. The landowner should be aware of the terms of the lease and should seek greater compensation for terms of the lease that are less favorable to the landowner. The lease provisions listed above, along with many other aspects of the lease, should be considered carefully given the long term of commitment required by many leases. Negotiation of an equitable lease requires the assistance of effective legal counsel. If satisfactory terms or compensation are not provided in the lease, new or additional terms should be negotiated or the lease should not be signed.

XII. Other Resources

Noling, Bernard. *Guidelines for Landowners in Negotiating Wind Energy Leases*. Speech, Southwest Kansas Royalty Owners Association, 2003. (Retired attorney reflects on experience of reviewing wind energy leases in Texas and Kansas and the problems that landowners can experience with a poorly negotiated lease – very readable and a must-read for any landowner). Available at <http://www.swkroa.com/formspublications.html>

McEowen, Roger A. *Wind Energy Production: Legal Issues and Related Concerns for Landowners*. Center for Agricultural Law and Taxation, Iowa State University. Available at <http://www.calt.iastate.edu/windenergy.htm>

Windustry. *Leasing Your Land to a Developer*. Available at <http://www.windustry.com/leases>

Windustry. *Leases and Easements*. (Includes “webinar” presentations from Iowa State University and Colorado State University). Available at <http://www.windustry.com/taxonomy/term/120>

Stoel Rives, LLP, Attorneys at Law. *The Law of Wind: A Guide to Business and Legal Issues*. 2006. (If your attorney is unfamiliar with wind energy leases, be sure to direct him/her to this publication.) Available at <http://www.swkroa.com/formspublications.html> (Also available at the windustry.com website above.)